

SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS  
BY FEDERAL RESERVE DISTRICTS

June 1990

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## SUMMARY\*

The tone of District reports suggests continued slow growth in the economy with little change in the underlying inflation rate. Reports on the behavior of consumption are mixed, and construction is indicated to be softening further. Capital goods industries are, on balance, pointing toward growth, and manufacturing is expected to strengthen in several Districts.

Recent behavior in retail sales and reports from retailers in several Districts indicate that sales have been slow in recent months, and are expected to remain so in the short term. It is unclear how much of the recent softness in retail sales represents temporary factors, such as unusual weather over the last several months.

Both residential and nonresidential construction have been edging downward in recent months in most Districts, and indicators of future construction suggest further softening.

Prospects for a good harvest this year should be improved as a result of ample rainfall in previously drought-stricken regions of the country, but cool, wet weather has delayed planting by as much as several weeks.

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\* Prepared at the Federal Reserve Bank of Cleveland and based on information collected before June 8, 1990. This document summarizes comments received from businesses and other contacts outside the Federal Reserve and is not a commentary on the views of Federal Reserve officials.

The slow-growth economy is accompanied by an easing in demand for credit. Real estate loans, consumer loans, and business loans are still growing, but at reduced rates in recent months. Lenders are reported to have tightened standards especially for real estate loans, but there is still little information that suggests credit restraint is spreading into other markets.

#### CONSUMER SPENDING

District reports suggest very little growth, if not a decline, in real consumer spending for durable and nondurable goods this quarter from last. Retail sales have been marked by sluggish behavior in several Districts that has apparently continued into May and early June (Boston, New York, Philadelphia, Cleveland, Chicago, Richmond and St. Louis).

Unseasonably cold and wet weather has reduced demand for summer goods and for apparel. Weakness in home furnishings is attributed to softened conditions in housing.

Retail sales in Atlanta, Dallas, and Minneapolis apparently continued to increase in May, but at a reduced pace from earlier this year. Kansas City described retail sales as having increased moderately over the past three months, and San Francisco described sales as "continuing healthy."

Several Districts reported that retail inventories are either high, or larger than desired (Boston, Philadelphia, Cleveland, St. Louis, and Kansas City).

Retailers in several Districts are cautious about the short-term outlook for retail sales. In Boston and Cleveland, respondents apparently expect little improvement at least through the summer months, and Philadelphia reports that some retailers are lowering their sales forecasts.

## MANUFACTURING

Manufacturing production has been relatively flat over the last few months, but several Districts expect strengthening in output despite softness in some industries. Defense, building construction machinery, and apparel industries are experiencing some softening. In contrast, the aerospace industry is a source of strength in several regions of the country, (Boston, Minneapolis, and San Francisco), and the energy sector is expanding (Dallas and Kansas City).

Capital goods industries still point toward growth, despite mixed performance. Construction machinery, excluding building, is "doing well," agricultural machinery is strong, and orders for communications equipment are rising, according to Chicago. Demand for heating and air conditioning and industrial pumps is strong in Atlanta, and capital goods is "surprisingly strong" in Minneapolis. Cleveland reports that capital spending plans are stronger than reported in the latest Commerce Department survey, which should be an important support to manufacturing output.

Output in the auto and auto-related industries, such as glass and rubber, has been a drag on manufacturing in Atlanta, but Chicago and Cleveland note some strengthening in auto production that should add to total output this quarter and perhaps next. Steel production has rebounded, and some analysts have upgraded their steel outlook for 1990 (Chicago).

## CONSTRUCTION AND REAL ESTATE

In most Districts, except San Francisco and Minneapolis, residential and nonresidential construction has been flat to declining in recent months, with prospects for further easing. Housing sales were either flat or fell in recent months in Philadelphia, Richmond, and Kansas City, but were generally

stronger in Minneapolis, and rebounded in California. Housing sales have been increasing at double-digit rates in Oregon, Idaho, and Utah.

Contract awards for future starts fell in April in Chicago and Dallas, and permits in Minnesota were off 20% in March from a year earlier. Atlanta notes that contracts for both residential and commercial construction continue to slow, in part because of overbuilt markets.

An underlying problem in commercial construction is an apparent excess supply of new office space in many parts of the country. Commercial construction in downtown Manhattan is marked by the highest office vacancy in two decades. Dallas notes that office occupancy rates in major metropolitan centers in that District have been increasing, but are still low.

#### AGRICULTURE

Recent rains in the Southeast, the North Central states, and California generally relieved drought conditions and appear to have improved farm crop yields. Richmond reports that grain yields are expected to be normal to above normal. Recent rains in the North Central states "substantially brightened prospects for agriculture," especially in Minnesota and North Dakota, and ranchers in Montana expect a record year this year (Minneapolis). Kansas reports heavy spring rains ended the drought of the past two years and boosted prospects for winter wheat output. Expected yields range from average to well above average, with record yields likely in much of that state. Recent rains in California have relieved some of the drought conditions, but storms have caused significant damage to some fruit crops.

Heavy rainfalls in the Chicago, St. Louis, Kansas City, and Dallas Districts however, have damaged crops and delayed other crop planting by several weeks. Below-normal temperatures and above-normal rainfall since

mid-May have delayed planting of an estimated 13% of corn acreage and 47% of soybean acreage as of June 2, according to Chicago. St. Louis reports that poor weather and disease and insect problems suggest that 1990 crop yields may fall below normal in some parts of that District. Moreover, an estimated one-fourth to one-half of the wheat and cotton crop is rated as in poor to very poor condition in several states.

#### CREDIT MARKET CONDITIONS

Loan demand continues to expand, although the pace has eased for most types of loans. Philadelphia reports easing in growth for most loans, and Atlanta comments that weak loan growth has led lenders to encourage borrowing. Home equity loans continue to rise in New York and Richmond, although growth in Philadelphia has slowed along with other kinds of consumer loans.

Constraints on credit seem to be primarily in real estate, although limited information suggests small business firms in some areas may also be affected. New York notes that home builders report a shortage of credit for acquisition and construction loans is becoming a major problem, especially in downstate New York and northern New Jersey. Cleveland points out that credit restraint is largely confined to multi-family construction and commercial buildings, but that there appears to be ample funds for single-family housing. San Francisco reports that "lending standards have become more stringent in recent months," and both Richmond and St. Louis reported about credit constraints for the first time this month.

## FIRST DISTRICT-BOSTON

Economic activity in the First District has been weak in recent months. Although some retailers reported sales modestly above year-earlier levels, in most cases sales were flat to down and inventories were high. Reports from manufacturers were slightly stronger: sales and orders were generally above year-ago levels, and inventories were in line. In both sectors, input and selling prices were fairly stable. No employment increases are planned, and staffing is down at a number of contacts. A recently released forecast foresees continued employment losses in the region through the end of 1990 and no significant job growth until 1992.

Retail

Retail sales in the First District were uniformly reported to be slow in recent months. Some retail contacts enjoyed modest sales increases compared to a year ago, but the majority said that sales were flat or down and that inventories were excessive. Housing-related goods and clothing were especially weak. Several firms reported very poor sales in May, as cold, rainy weather limited traffic and depressed demand for summer items. Some contacts believe the slowdown is more a matter of consumer confidence than ability to spend.

Selling prices were widely reported to be fairly flat as a result of promotions and stability in supplier prices. Gross margins were mixed, but were more often down than up.



Most retail respondents are now hiring only to fill vacancies. Some sellers of durable items have reduced employment over the past year.

All retail contacts expressed caution about the future. None foresees any pickup soon, although a few hold out hope for this year's fall and Christmas seasons. Despite their concerns, about half the respondents (mostly department and general merchandise chains) will continue with plans to open new stores in the coming year.

### Manufacturing

Most First District manufacturing contacts continue to experience slow growth. Two-thirds report that sales and orders are above year-ago levels, with gains ranging from marginal to 15 percent. Elsewhere, shipments and orders are down by as much as 7 percent. Areas of comparative strength include telecommunications, defense-related electronics, shipping equipment and the aerospace overhaul business. Several firms say that new products are performing well. By contrast, demand from the construction, electric utility and auto industries was relatively weak. Two respondents expect a decline in auto company orders by year-end, because they believe that auto makers are currently building inventory for a possible strike later this year. Several contacts mentioned that growth in exports, especially to Asia, is slowing.

Inventories are generally termed satisfactory. In several cases inventory levels are lower than at this time last year. Employment is also 1 to 3 percent below year-ago levels at most manufacturers contacted. No respondent plans to increase employment in 1990, and further declines are expected. Respondents mentioning wages expect 1990 increases to range from 3 to 7 percent.

Input prices are said to be stable, reportedly rising 1 to 2 percent at most. For a majority of respondents, selling prices are unchanged or down from year-ago levels. These firms have responded to increased domestic and Japanese competition by lowering prices, discounting or introducing "stripped down" versions of some products. A few of the firms surveyed have passed on increases in materials prices to customers or have achieved selective price increases ranging from 2 to 5 percent. Although a third of the contacts suffered losses or a decline in profit margins in recent months, several expect improved profitability by year end.

Capital spending will remain at 1989 levels, according to most manufacturers contacted. However, weak demand is causing two firms to reduce their capital spending plans for this year.

Most First District manufacturers foresee little change in economic conditions this year. In general, they expect their firms to grow faster than the national or regional economies.

#### Outlook

The New England Economic Project (NEEP), a nonprofit organization comprising businesses, government agencies and educational institutions, released its semi-annual forecast at the end of May. The forecast calls for nonagricultural employment in the region to decline slightly in 1990. Regional employment will stabilize in 1991 and grow moderately in 1992, as manufacturing job losses abate and nonmanufacturing jobs expand gradually. The hard-hit construction, finance, and real estate industries are not expected to turn around until 1992. NEEP forecasts that the region's unemployment rate will stay slightly above the national average until the end of 1992.

## SECOND DISTRICT--NEW YORK

Recent reports on District developments have tended to be somewhat weak. Retail sales were generally sluggish and in some parts of the District homebuilders reported that a shortage of credit is becoming a major problem. Office vacancy rates in Manhattan have reportedly reached their highest level in two decades but have stabilized in some other parts of the District. Nonetheless, District unemployment rates remain below the national average. Small and medium-sized banks stated that the demand for home equity loans is unchanged from a year ago.

Consumer Spending

District retail sales were generally sluggish since the last report. Two chains reported strong over-the-year gains during April and a marked slowdown in May, while others noted a slight improvement in May but with results that were well below plan in both months.

During April over-the-year changes in sales ranged from -6.9 percent to +14.0 percent with several stores reporting declines despite Easter's falling in April this year. Year-to-year changes in May covered a narrower range--from -8.0 percent to +1.0 percent. Rain and unseasonably cold weather were cited as major factors behind the recent sluggishness, though one retailer characterized it as a more generalized slowdown in consumer spending which might or might not continue. Home furnishings and women's apparel were mentioned as the weakest selling items.

Despite the disappointing sales results, for the most part inventories remain in good shape due primarily to careful monitoring. Indeed, the reluctance of some suppliers to provide goods to stores in bankruptcy or with substantial debt has in some instances reportedly resulted in somewhat lower-than-desired inventories.

Residential Construction and Real Estate

In some parts of the District homebuilders reported that a shortage of credit for acquisition and construction loans is becoming a major problem. This was

particularly true in downstate New York and northern New Jersey, where many commercial banks as well as thrift institutions were described as reluctant to lend. One respondent noted increased buyer interest in the resale market because of more realistic pricing, but expressed concern that potential "move-up" sellers may be stymied if homebuilders are unable to obtain the necessary funds for construction.

In both midtown and downtown Manhattan office vacancy rates have reportedly climbed to their highest levels in two decades as new buildings are completed in midtown, and financial services firms continue to contract and place superfluous space on the downtown market. In contrast, office vacancy rates have stabilized recently in other parts of the District including Westchester and Fairfield counties, northern New Jersey and Long Island. This has resulted from a slowdown in the delivery of new buildings together with strong leasing activity in some areas.

#### Other Business Activity

District unemployment rates in May remained below the national average. New Jersey's rate edged down to 4.8 percent from 4.9 percent in April while New York's rate rose to 5.1 percent from 4.9 percent. The growth in Second District nonfarm employment has lagged the national pace since 1986, however, due to substantial declines in the manufacturing sector and slower gains in nonmanufacturing industries.

The percentage of Buffalo purchasing managers reporting a decline in new orders rose sharply in April as did the number of firms with lower production. The percentage of managers reporting higher input prices also increased.

In response to an expected decline in defense outlays, G. E. Aerospace announced plans to eliminate 4200 jobs over the next two and a half years with 50 percent of the job losses in upstate New York. A partial offset will be the creation of 500 new jobs at a new G.E. electronic parts manufacturing center outside Binghamton, New York. In New York City, the second phase of a conversion of the Brooklyn Army Terminal into an industrial park is scheduled for completion this month. With 94 percent of the first phase already rented (primarily to printers and garment/accessories manufacturers), the City estimates that 4400 will be employed at the facility by year-end.

Expressing concern over the state's financial condition, its heavy debt load, and economic uncertainties in the region, Moody's Investors Service lowered its rating on New York's general obligation debt as Standard & Poor's did earlier. Only Louisiana and Massachusetts now have a lower rating. New York State adopted a budget calling for a total of \$1.4 billion in revenue increases. The New Jersey legislature continues to consider increasing revenues \$1.4 billion to balance the budget. A further \$1 1/4 billion proposed income tax increase would be mostly used to increase state aid to poorer school districts. According to press accounts this plan is broadly consistent with a recent New Jersey Supreme Court ruling.

#### Financial Developments

Based on a survey of small and medium-sized banks in the Second District, demand for home equity loans is generally unchanged from one year ago. While one banker noted that falling home values have eroded borrowers' collateral and driven down loan demand, another stated that declining home values had a positive effect because borrowers are reluctant to sell their homes at lower prices and are instead opting for home improvements. Most bankers anticipate strong demand for home equity loans over the next year since the tax deductibility of interest payments on other types of consumer loans is expiring at year-end.

Home equity loans as a share of consumer loans generally range between 15 and 35 percent at the surveyed banks. At most banks this share has increased over the last year. However, respondents also stated that, in general, their lending policy has become more conservative. Some noted that they are staying away from speculative loans, such as those collateralized by non-owner occupied real-estate, and a few bankers stated that they are basing ability to pay more on income than on collateral. Almost all bankers surveyed said that their loan-to-value ratio has been reduced, or is expected to be reduced soon, and many noted that they are discounting the appraisal value of homes. All but one banker said the interest charged is tied to the prime rate with most charging 2 percentage points above the prime. Bankers expect to continue charging this rate on home equity loans.

## THIRD DISTRICT - PHILADELPHIA

Economic conditions in the Third District in June varied among major sectors, with most marked by some signs of current or developing softness. Manufacturing activity was close to levelling off after a year-long decline although employment was still being cut. Retail sales were barely up from a year ago, in current dollars, with results hampered by slow sales of summer goods, and auto sales have declined. Bank lending was fairly healthy year-over-year, but there were indications that growth was ebbing. Real estate activity, both residential and commercial, was sluggish, and construction, especially of offices, was dropping.

The outlook in the Third District business community is subdued. Manufacturers generally foresee a modest increase in production in the second half of the year, but they do not expect to step up hiring. Retailers are being cautious in their sales forecasts for the balance of the year, and they said planning is complicated by continued uncertainty with respect to industry restructuring. Bankers expect loan growth to continue to slacken as a result of weakening loan demand and tightening of credit standards.

MANUFACTURING

Third District manufacturers contacted in late May and early June gave indications that the year-long decline in activity might be levelling off. Over half of the firms surveyed said business was running at a steady pace, and the number of firms reporting improved business nearly matched the number noting declines. Although the overall picture is one of little change, reports by industry sector vary widely. Improvement was noted among producers of chemicals, electrical machinery, and stone, clay, and glass products. Most of the firms experiencing slower business were producers of nondurable goods such as apparel,

food products, and paper and paper goods, although primary metal producers indicated some weakness, also.

Overall, Third District manufacturers noted a steady rate of new orders, a marginal pickup in shipments, and a drop in order backlogs. Although most of the firms surveyed were maintaining steady employment levels and working hours, on net, they continued to make fractional cuts in personnel and hours. Industrial prices in the region were steady, with three-fourths of the companies polled holding prices of their products steady and nearly nine-out-of-ten reporting stable input costs.

Looking ahead, Third District manufacturers generally foresee improvement in the second half of the year. On balance, they expect a pickup in orders and they plan to boost shipments accordingly, without a buildup in order backlogs. Although they expect to step up the pace of production, area firms are planning to hold the line on working hours and make some further cuts in payrolls by the end of the year.

#### RETAIL

Reports from Third District retailers in June indicated that sales in the region were generally running only marginally above the pace set last spring, in dollar terms, but with a great deal of variation from store to store. Auto sales were running below the year-ago rate. Merchants said that no particular product lines were standout successes or laggards, although there were reports that summer goods got off to a slow start. Retail executives attributed the greater than usual store-to-store variance to specific situations, and they said differences in stocking levels, pricing, and product quality accounted for the range of performance. According to merchants, consumers are shopping carefully for the best price and quality combination on goods for which they feel relatively urgent need, and are not spending freely.

Third District merchants were growing more cautious in their outlook for the rest of the year. Several said they have been trimming sales forecasts since early spring and they saw no signs of a pickup for the summer or fall. Some noted that discounting appeared to be spreading even to stores that traditionally have been able to avoid recourse to price reductions to spur sales. Merchants said that with excess capacity in retailing and little evidence of resurgent economic growth, prospects for the industry will not brighten soon.

#### FINANCE

Total loan volume at major Third District banks in mid-May was approximately 13 percent above the May 1989 level. Loan growth has continued on a steady pace for the past three quarters, but bankers contacted in June saw signs of a slowdown developing. Consumer lending, although strong year-over-year, has begun to slip, according to bankers. They reported a drop in auto loans in line with falling auto sales, and easing growth in home equity, credit card, and other installment outstandings. Commercial and industrial lending was described by bankers as growing modestly, but they expect growth to lag as loan demand eases and tighter credit standards are implemented, especially for construction financing. Bankers also generally reported a continuing moderation in the growth of real estate financing, both commercial and residential.

#### REAL ESTATE AND CONSTRUCTION

Real estate markets remain soft throughout the Third District. Realtors and mortgage lenders indicated that housing sales were sluggish and average selling prices were declining as sales of higher-priced homes have fallen off more than sales of lower-priced homes. Realtors believe activity in the higher price ranges has slackened because concern about job security has risen among typical move-up buyers (cutbacks in the financial services and defense industries were mentioned) while first-time home buyers are still motivated to buy, and are



able to obtain mortgages.

Commercial and residential construction continued to decline in June as office vacancies increased and credit available to developers shrunk. Suburban office and speculative housing construction were relatively weakest, while industrial construction, which is not typically speculative, and pre-sold residential building retained some health.

## FOURTH DISTRICT - CLEVELAND

Summary. Fourth District respondents are a little more optimistic about short-term prospects for manufacturing than they were several weeks ago. Higher motor vehicle output should add to overall output this quarter. Capital spending plans from the sample of District manufacturers call for larger spending increases than indicated in the latest Commerce Department survey, and export growth is expected to continue at least through the balance of this year. Respondents, however, appear more cautious about the short-term outlook for consumer spending. Lenders and borrowers acknowledge tightening in credit availability and lending standards in real estate, but also note that other declines in lending are due to easing in demand for single-family houses and for consumer credit.

Employment and Output. The 5.9 percent unemployment rate in Ohio in April and May has been relatively unchanged since last fall, despite monthly fluctuations. Employment in manufacturing has held steady, and services employment has continued to grow, albeit slowly.

Respondents report that manufacturing output rose in May and expect that second quarter growth in output, particularly in autos, will be stronger than in the first quarter. Higher auto output should add between 0.5 and 1.0 percentage point to the real GNP growth rate this quarter.

Capital Spending. District manufacturers are more optimistic about capital spending for 1990 than reported in the latest Commerce Department survey. Respondents plan larger percentage increases in nominal outlays this year than last, and all but one report that they plan to increase their capital spending this year by a larger percentage than the planned 3.4 percent

indicated in the latest Commerce survey. A few manufacturers plan to add capacity for products that were in short supply during the peak 1987-88 period. Others mentioned the need for product quality improvement and for further modernization of facilities. Some also remarked that 1990 may be the peak year in their multiyear capital spending programs. Most respondents mentioned that they plan to finance most of their 1990 capital spending from internally generated funds. They expect that profits from production will revive this quarter. The run-up in interest rates earlier this year was not judged to be a deterrent to spending plans for 1990 because real rates of interest did not change much.

Exports. Multinational firms as well as smaller businesses headquartered in this District report that overseas markets remain generally strong, although some expect a slowdown in U.S. export growth later this year. Capital goods producers were optimistic about export prospects again this year. Exchange rate changes apparently have not had much effect on exports so far in 1990. A capital goods producer commented that costs of parts and sub-assemblies have risen in recent months, but that changes in exchange rates of even 10 percent to 15 percent are "swamped" by rapid improvement in technology. An auto parts producer reports that effects of dollar appreciation relative to the yen may be less than expected because Japanese auto producers are attempting to use American-produced products where possible to meet domestic-content goals for new cars. Several export-sensitive firms are concerned that anti-inflation policies in Brazil will either reduce exports to that country or diminish earnings from their plants located there.

Consumer Spending. Major retailers report disappointing May and early June sales volumes, especially for apparel, which they attribute to

unseasonable weather, slower income gains, and more competition from discount stores. Home furnishing sales also weakened. Another retailer reports good sales over the past several weeks, however, apparently in response to an upgrading of its merchandise. Two large retailers contacted report that inventories are high relative to their objective. They also expect soft sales, at least through the summer months.

Financial Markets. Most respondents acknowledge that credit standards have tightened, but report that ample funds are available except for real estate and for highly leveraged transactions. Some large commercial banks apparently are not presently interested in development and construction loans, while some others are still making those loans, but with terms that could include a few percentage points above prime, extensive documentation, and personal guarantees.

The problem in real estate appears to be in multifamily housing and in commercial buildings, where developers and builders complain that it is "hard to find lenders." Lenders, for their part, emphasize prudence in their exposure to this sector of the economy. Small builders, especially of single-family units, report funds are still ample, although FIRREA legislation has forced a search for credit away from traditional lenders, generally thrifts. According to one report, the major complaint among single-family builders is a sluggish demand for houses rather than unavailability of credit.

At present, there is little to indicate that credit conditions have tightened in other parts of the regional economy. Bankers report that recent slowing in growth of consumer credit is due to softening demand rather

than to tightened supply of credit. A few lenders noted that consumer spending could be dampened if lines of credit based on equity in homes are reduced.

## FIFTH FEDERAL RESERVE DISTRICT

Overview

District business and financial conditions were generally unchanged in May. Manufacturing activity softened somewhat, but manufacturers remained optimistic about prospects for the national economy and their own businesses. Retail sales changed little from April levels, and tourism was mixed. On balance, exports rose at District seaports while imports were unchanged. Housing starts fell, but home sales remained stable. Home mortgage and home equity lending increased at District financial institutions, but the demand for commercial and industrial loans declined slightly. In the farm sector, planting was ahead of schedule and the harvest of early grains had begun.

Manufacturing

Our regular mail survey showed that District manufacturing activity apparently slowed somewhat in May from April. Although a majority of respondents reported no change in shipments, inventories, employment, new orders and unfilled orders, more respondents indicated declines than increases--a reversal of the results of our previous survey. Three-fourths of those surveyed reported no change in new export orders, and most others indicated increases.

Manufacturers remained optimistic that expansion in the national economy would continue. More than 80 percent expect their own business activity to stay the same or improve along with the U.S. economy in the coming months.

Consumer Spending

Responses to our regular mail survey of District retailers indicated that non-auto retail sales remained unchanged in recent weeks. There was some additional inventory accumulation and a small decline in shoppers, however.

A telephone survey of resort hotels in the District suggested that tourist activity has been mixed so far this spring. Half of the hotels reported increases over last year in their business through May and in their bookings for the summer. The other half, located mainly in Maryland and South Carolina, reported declines in tourism this year compared to last year.

#### Housing

A survey of District mortgage lenders, realtors and home builders suggested that housing activity remained mixed in May. Lenders reported that the demand for mortgage loans in May and early June increased from the April level. They attributed the additional activity to lower mortgage rates.

Realtors indicated that home sales in all price ranges during May remained at April levels. Housing sales in the District, although sluggish so far this year, have been above the pace of 1989 and realtors are optimistic that sales activity will pick up in the months ahead. Many potential home buyers, they said, are either waiting for their current homes to sell or for mortgage rates to decline further.

Most home builders contacted said they started fewer homes in May than in April. The new starts were targeted largely for the middle and upper price tiers of the market. May sales of new homes were depressed, the builders noted, and there is now a large inventory of unsold homes. Most builders complained about their difficulties in obtaining credit.

#### Port Activity

Exports rose in May from April levels at the seaports in Baltimore and Charleston and stayed about the same at Hampton Roads. Imports were higher at Hampton Roads, about the same at Charleston, and lower at Baltimore. Compared to a year ago, port activity was mixed, with increases in both exports and imports at Hampton Roads, no changes at Charleston, and decreases at Baltimore.

The Baltimore port representative looks for exports to increase faster than imports over the next six months, while representatives from the other two ports expect export and import volumes to increase at the same rate.

### Finance

Reports from District financial institutions indicated that commercial and industrial loan demand decreased slightly in May from April. Respondents attributed the decline to borrower uneasiness about economic growth, tax increases and interest rate changes. Some lenders felt that potential borrowers may have perceived credit to be unavailable, and several lenders said they were reluctant to make loans because of stricter regulatory guidelines and the depressed commercial real estate market.

Consumer demand for home equity loans remained strong in May. Over 90 percent of the bankers surveyed reported that the demand for home equity loans either remained at or increased from the April level. Lenders attributed the increase to marketing, seasonal factors and greater consumer awareness of the tax advantages associated with the loans. Over 85 percent of the lenders reported no recent change in the interest rates they charge on home equity and other consumer loans.

### Agriculture

Farmers reported that soil moisture in late May and early June was adequate to surplus in all District states except South Carolina. Recent rains in South Carolina, however, relieved the dry crop and pasture conditions in that state. In North Carolina, heavy rains caused scattered flooding and damaged crops in some areas. Our contacts indicated, however, that spring planting progressed faster than normal despite the spring rains. In early June, corn and peanut planting in the District was nearly complete and soybean planting was well underway.



The harvest of small grains has begun around the District. Most small grain crops--oats, wheat, rice and barley--were reported to be in good condition and yields should be normal or above.

## SIXTH DISTRICT - ATLANTA

Overview: Consistent with reports received since March, our business contacts continue to indicate generally slow growth throughout the Southeast. Retailers around the District convey a mixed picture, but generally note that sales growth is slower than last year with apparel doing well and durable goods picking up but still off from last years pace. Reports from auto dealers continue to show sales at or below last years levels. Manufacturers, except for textile, auto and auto-related producers, are seeing some strengthening of sales, which is allowing planned capital expenditures to progress. Because of generally overbuilt markets, contacts in the construction sector continue to indicate weakness and see no quick relief. Financial institutions again report weak loan growth. Little wage or price pressure is being reported in the District, although reports of shortages of skilled workers are increasing.

Retail Sales: Retail activity in the District is generally reported to be growing but at a rate somewhat slower than last year. Apparel continues to be mentioned as the backbone of sales growth; several merchants indicated some pickup in durable sales. Department store contacts report sales growth on a par with or slightly above expectations earlier this year. Appliance and other consumer durable sales have reportedly declined recently in line with the slowdown in residential real estate sales in certain areas. However, contacts report that furniture sales in the Southeast have picked up in recent weeks and are now growing a percentage point or two faster than last year's levels. Reports from do-it-yourself specialty stores indicate strong growth in building materials and related sales.

Reports from auto dealers indicate that sales weakened further recently and one contact speculated that rumors of increased manufacturers incentives on the forthcoming 1991 models are hurting current sales. A majority of the dealers, however, expect some pickup in activity

in coming months, especially if those dealer and/or consumer incentives are put in place by manufacturers.

Manufacturing: Manufactures in the District point to a mixed picture, but those not associated with textile or auto and auto-related production generally indicate that activity levels are picking up. The slowdown in new residential construction, which reduces demand for new carpets and drapery, and greater competition from foreign apparel producers are reportedly taking their toll on southeastern textile and apparel producers. Job losses continue to be reported in these industries although contacts generally believe activity will pickup in the third quarter. The weakness in auto manufacturing is reportedly affecting suppliers; tire and glass producers are the most recent to feel the strain. One glass producer has been adversely affected by both the slowdown in auto production and construction, and is trying to offset the impact by lowering prices and emphasizing export markets. Manufacturers of heating and air conditioning equipment report that consumer demand has strengthened over first quarter levels, especially for replacement equipment. Producers of industrial pumps and metering equipment report record sales caused mostly by increased export demand. Pulp and paper producers also report benefiting from strong export demand. Producers of marine equipment are reporting a noticeable improvement in business activity and attribute this to the improvement in the oil and gas industry. These producers indicate that capital spending to expand capacity is now being actively considered. Despite current weakness in demand, certain manufacturers of major household appliances and fixtures report that they are building new manufacturing facilities in the Southeast.

Real Estate and Construction: Construction contacts continue to indicate weakness in residential and commercial construction. They attribute much of the weakness to overbuilt markets but reports of more stringent lending conditions imposed by financial institutions continue. Public infrastructure and industrial building are the only sectors where strength is

reported. Reports from Florida indicate that the new limits on loans to a single borrower imposed on savings and loans and a new state law requiring concurrent additions to public infrastructure in conjunction with new developments are also adversely affecting construction in that state, and our contacts around the District indicate no relief to this construction slowdown is in sight.

Financial Services: Several bankers noted a continuation of weakness in consumer loan demand. These bankers report business loan growth is also slow. However, the majority of our bank contacts indicated no change in credit policies and none of our business contacts indicated problems obtaining credit. Businesses that are doing well report that financial institutions are encouraging them to borrow. One of our contacts also indicates that his institution has tightened its lending standards--requiring stricter documentation and more collateral--in the last few months, especially for real estate loans and to a lesser degree for small business lending.

Wages and Prices: Reports from around the District reveal little change in wage or price pressures. A few of our contacts noted that certain types of skilled labor are in short supply, but these tight markets are localized and have not resulted in increased wage pressures. With the resurgence of the energy sector, contacts noted that qualified welders and pipe fitters are in especially short supply. No new price pressures were mentioned by our contacts.

## SEVENTH DISTRICT--CHICAGO

Summary. Contacts in the Seventh District report weakening in construction activity and retail sales, while manufacturing activity remains mixed but generally improving from weakness early in the year. Residential and nonresidential construction has slowed in recent months, although the District is still outperforming the nation on average. General merchandise sales are weakening in market segments linked to housing activity, particularly furniture and appliances. However, trends in most other products are unchanged, with apparel sales soft and entertainment-based electronics sales providing most of the growth. In manufacturing, auto-related industries have improved from the first quarter's weak performance, but several capital-goods producers report that expanding segments are being offset by slowing segments of their markets. Weather conditions from late May to early June slowed plantings and damaged crops in the District.

Construction and Real Estate. Nonresidential construction in the District as a whole continues to outperform the nation, but construction activity in some District states has declined in recent months. A producer of building materials reports that nonresidential construction awards (in floor area) in the first four months of 1990 were up 7 percent from a year ago for the District states, compared to a 10 percent decline nationally. However, Michigan and Wisconsin both registered declines in April. Illinois declined in March, but was positive in April. A large Chicago-area building materials supplier noted that shipments in April were below year-ago levels, although year-to-date shipments were up. Some projects in the planning stage are reportedly being pushed back, but so far few have been cancelled. Chicago's office vacancy rate is below the nation's, according to one contact, but vacancy rates in its suburbs are now slightly above the national average. Commercial sales of existing office space are unchanged from a year ago, but a commercial realtor notes that institutions providing financing are paying increasing attention to "quality."

Residential construction in the District is following a pattern similar to the nonresidential sector. Contracts for housing construction were up 10 percent in the District, compared to an 8

percent decline nationally for the first four months of 1990. However, the District dropped 3 percent in April from year-ago levels, with Illinois accounting for the bulk of the decline. A Chicago-area realtor reports that local residential sales were up in April, May, and early June over a year ago, after being flat for several months. Housing prices are edging up, but have slowed sharply from the year-ago pace as houses take longer to sell. Some large banks in early June have dropped their mortgage rates on average about a half a point to slightly below 10 percent.

Consumer Spending. General merchandise sales in the District have been weakening since April, according to several retail analysts, reflecting in part the housing slowdown and special factors. An analyst for a major retailing chain reports that sales of major appliances fell sharply in April and May, led by household improvement goods and household furnishings. Overall, sales growth in the District has been about equal to overall sales growth for the chain, after outperforming the nation earlier in the year. An analyst for a nationwide discount chain reports that the Midwest was their only market region to experience declining sales in May. Store sales were hurt in part by the expansion of new discount chains into the region and by liquidation sales at stores in bankruptcy. An appliance producer reports that shipments, down 6 percent in the year-to-date through May, are weaker than expected.

Sales of apparel goods continued to be weak in early June. Apparel sales, according to one analyst, have been hurt by unseasonably cold weather and consumer resistance to higher prices. Higher prices were attributed in part to a slackening of competitive pressures after several retail chains filed for bankruptcy. Most of the sales decline in apparel is concentrated in women's apparel, with men's and children's apparel showing modest strength.

Manufacturing. Manufacturing activity in the District continues to be mixed, with strength in auto-related industries more than offsetting weakness in construction-related industries. An auto analyst reports that the expected rebound from last quarter's weak auto production includes some seasonal inventory building, as auto makers prepare for the changeover to 1991 model production. Inventory levels are viewed as being in good shape,

running 20 percent below a year ago despite sales being down 10 percent. Steel production this quarter is expected to nearly equal last year's second quarter high, according to a steel analyst, who has revised estimated output for 1990 upward by 5 million tons to 82 million tons (compared to 84 million tons in 1989).

Capital-goods producers generally report mixed activity, following the overall pattern of manufacturing. A producer of heavy equipment states that District plants that make highway construction and mining equipment are doing very well, but plants that produce heavy equipment tied to building construction are slowing down. A producer of agricultural equipment reports continued sales strength especially for combines and four-wheel drive tractors. However, agricultural equipment sales are expected to begin slowing by the end of the year, as replacement demand softens. Sales of light industrial equipment, which follows the housing industry closely, are down 10 percent from a year ago. A producer of food processing and material handling equipment notes some softening in orders from very high levels. A materials supplier cites strength in the demand for pumps and compressors, coming in part from new chemical plants, and for plastics-making equipment, coming in part from overseas. An economist for a large electronics producer reports that orders for communications equipment have returned to double-digit growth rates and shipments are expected to reach double-digit rates by the end of the year. Orders for electronic components used in computers are still relatively weak, but are beginning to show some improvement.

Agriculture. Cool temperatures and frequent rainstorms from mid-May through early June slowed crop plantings, caused ponding and plant-emergence problems in some planted fields, disrupted haying operations in many areas, and resulted in pollination and frost damage problems for some fruit growers in Michigan and Wisconsin. Some 13 percent of the corn acreage and 47 percent of the soybean acreage in District states had not yet been planted as of June 2, a date when plantings are normally winding down. The planting delays were most apparent in Southern Illinois and Indiana. Faced with a June 8 to 15 planting deadline, some of this year's intended corn acreage will likely be shifted to soybeans.

## EIGHTH DISTRICT - ST. LOUIS

Summary

Contacts generally report slow economic growth throughout the District, with few expecting any substantial decline in activity in the near future. Manufacturing activity is flat. Many of the District's largest commercial banks have tightened credit standards for loans to small and mid-sized businesses. Excessive rainfall has damaged crops and delayed planting.

Consumer Spending

Non-auto retail sales growth is described as weak-to-moderate by contacts in most parts of the District. Survey responses indicate that the number of retailers with larger-than-desired inventories, though still a minority, rose substantially from a year earlier. Most District contacts describe car sales as flat or below year-earlier levels, despite the continued availability of sales incentives. Moderate growth of truck and used car sales has been reported for some areas.

Labor Markets and General Business Activity

District manufacturing employment has been flat in recent months; at the same time, nonmanufacturing employment has grown at a moderate pace, with the most growth occurring in wholesale and retail trades, government and services. Medical services, in particular, have shown moderate-to-strong job growth in most metropolitan areas. Only slight increases in construction employment have been reported, with slight declines occurring in the financial and the transportation, communication and utilities sectors. Regional unemployment rates have fallen slightly in recent months, in part because workers were recalled



to factories producing home appliances and autos. A recent survey indicated that approximately one in five small businesses were having difficulty filling some job openings, about the same proportion as a year ago.

Military restructuring and defense spending cutbacks are affecting some parts of the District. One contact reports that the pending reduction of a military base in Kentucky has caused retail sales to decline locally and the inventory of unsold homes to rise. A military installation that develops and tests equipment will eliminate approximately 260 jobs in St. Louis. A cut in military orders caused a sharp decline in production at a shoe factory in southern Illinois.

#### Manufacturing

Overall, manufacturing activity has been stable, with plant shutdowns and layoffs roughly equaling expansions and new operations. Makers of building materials are benefiting from the improvement in the Texas economy. One tire factory laid off many of its workers as orders diminished; in Arkansas, on the other hand, three plants that will produce steel cord for tires are under construction. Overall, growth in the construction of new plants producing motor vehicle parts is slowing, but some existing suppliers are expanding. Much of the District's manufacturing growth is in the production of nondurables. Some paper and food processing operations, for example, are expanding. New or expanding poultry processing factories were reported in Arkansas, Mississippi and Kentucky.

#### Banking and Credit

Senior loan officers at the District's five largest banks report non-merger-related commercial and industrial (C & I) lending fell from 1988 to 1989, but that no further slowing occurred in the first four

months of 1990. Most of these officers indicated credit standards had tightened somewhat for small and medium-sized businesses; a less favorable economic outlook, industry-specific factors and deteriorating loan portfolios were mentioned as reasons for the tightening. Credit terms for C & I loans to medium-sized firms (annual sales of \$50 to \$250 million) have tightened more than for smaller businesses. Both small and medium-sized firms are facing tighter loan covenants and collateralization requirements for C & I loans, with medium-sized firms also encountering lower maximum credit lines and increased loan rates over base rates. The officers also confirmed that credit standards for commercial real estate projects, especially office buildings and industrial structures, had tightened since late 1989.

#### Agriculture

Excessive rainfall over the District has delayed crop planting, damaged crops and caused flooding. Crop planting has been delayed the longest in northern portions of the District, where corn and soybean plantings are three-to-five weeks behind normal. Diseases stimulated by the cool, wet weather and insects have damaged the wheat and cotton crops. One-quarter to one-half of these crops are rated in poor-to-very-poor condition in several District states. District logging activity also has been limited by the wet weather. Areas adjacent to rivers sustained crop and livestock losses due to flooding throughout the District, with Arkansas being hit the hardest. Disaster assistance has been approved for almost half of Arkansas' counties. The combination of poor weather conditions and disease and insect problems indicate that 1990 District crop yields may fall below normal in some areas.

## NINTH DISTRICT--MINNEAPOLIS

Ninth District economic conditions have been moderately good lately, though there have been some signs of softening. Employment growth has been low, retail sales growth has fallen off, and new cars have been selling very slowly. However, some types of manufacturing have shown some strength, and conditions in resource-related industries have been excellent.

Employment, Wages, and Prices

Labor markets in the district, particularly in Minnesota, have shown some signs of softening recently. In April, Minnesota's unemployment rate hit 5.4 percent, its highest level in over a year. There has been essentially no growth in total employment since January in Minnesota. Elsewhere in the district, unemployment rates were generally lower this April than last, but the growth rate of employment has been low.

Wage and price increases have remained moderate in the district. Employers continue to report that health care costs have been rising rapidly. Some employers in Minnesota report that high worker compensation insurance premiums have induced them to self-insure. A Bank director reports that, in Minnesota's manufacturing industry, raw material costs have remained level while finished good prices have stabilized after rising fairly rapidly earlier in the year.

Consumer Spending

Retailers in the district report some slowing of sales growth in May after strong growth earlier in the year. One large retailer reports that sales from January through May were about 5 percent higher than in the comparable period last year, but that May sales were only 1 percent higher than in May 1989. Another retailer reports that sales in May were 15 percent higher

than a year ago while year-to-date sales were 25 percent higher. The relatively slow growth in May is largely attributed to cool, wet weather, and retailers remain optimistic. Inventories are reported to be at acceptable levels.

New car sales have continued to be very soft in the district, particularly compared to last year. However, some dealers point out that sales last May were unusually high because manufacturers offered rebates on their cars. Used car sales, which were strong earlier in the year, also show signs of slowing.

Housing sales have generally been strong in the district, but new housing construction has been low. In the Minneapolis-St. Paul area of Minnesota, housing sales were higher in April than in any month in the last two years and May sales were 9 percent higher than in May 1989. In all of Minnesota, the number of new housing permits issued was 20 percent lower this March than last. Much of this decline is concentrated in the Minneapolis-St. Paul area, where the number of new permits declined 34 percent.

Cool weather and rain haven't dampened the spirits of travelers in the district. Michigan's Upper Peninsula and Wisconsin's Arrowhead region are expecting a good summer. The number of people crossing the Mackinac Bridge into the Upper Peninsula is at a record high. Retailers in the area report strong sales to Canadian tourists. In Minnesota, the fishing season got off to a good start, and throughout the district, campgrounds are filled on weekends. North Dakota, South Dakota, and Montana expect some decline in tourist spending from last year because 1989 was their centennial year. Montana forests are green again, with few marks left of the fire at Yellowstone two years ago. Tourist activity in Montana is expected to be strong this summer.

### Manufacturing and Construction

Conditions in the district's manufacturing industries have been mixed. Suppliers to the aircraft industry report strong sales and a large backlog of orders, and a director reports that conditions in capital goods industries have been "surprisingly good." Strong growth is also reported in the printing industry and among manufacturers of scientific and medical instruments. However, the electronics industry in the Minneapolis-St. Paul area continues to experience problems, and suppliers to the defense industry report drops in production and in new orders.

Nonresidential construction in the Twin Cities area has been relatively weak. The dollar volume of contracts for future nonresidential construction in April was unchanged from a year ago. Vacancy rates for office space in this area are expected to rise sharply with the completion of several major projects.

### Resource-Related Industries

The district's resource-related industries appear to be healthy. The forest product industries remain strong, and so does mining--especially in Montana. Recent rains in the district have substantially brightened prospects for agriculture. Minnesota's farm fields are the wettest they've been since 1987, and only 12 percent of the fields are short of moisture. Meanwhile, North Dakota farmers are reported to be more optimistic than they have been in several years, and Montana ranchers expect a record year.

## TENTH DISTRICT - KANSAS CITY

Overview. Modest growth still characterizes the Tenth District economy. Retail sales continue to increase moderately, although new car sales have been mixed. Both retailers and manufacturers are attempting to trim inventories. Oil and gas drilling stabilized in May and remains stronger than a year earlier. Residential construction activity has generally been flat over recent months, as new home sales remain slow. Mortgage demand at thrift institutions remains weak, while loan demand at commercial banks is generally steady to up moderately from a month ago. Plentiful spring rains have apparently ended the region's two-year drought. The winter wheat harvest now getting under way is expected to produce above-average yields.

Retail Sales. Most district retailers report moderate increases in sales over the past year and over the past three months. Sales are expected to improve slightly in the months ahead. Prices have changed in line with cost increases and are expected to edge up further in coming months. Most respondents are attempting to trim inventories. New auto sales have slowed in some district states but have improved slightly in others. Some dealers report tightening credit terms for potential buyers. Most dealers continue to trim inventories because they expect only modest sales in coming months.

Manufacturing. Most purchasing agents report relatively stable prices for inputs over the past three months. Prices are expected to remain steady or increase slightly during the next three months. Agents report no problems in obtaining materials or workers and expect none for the remainder of the year. Most firms are trimming inventory levels by continuing to operate plants below capacity.

Energy. Oil prices remain about \$4 below their level at the beginning of the year. Despite softer oil prices, exploration and development activity

in the district remained stable in May and improved compared with one year earlier. The district rig count increased slightly from 263 in April to 266 in May, up 14 percent from May 1989.

Housing Activity and Finance. District housing activity is slightly down from a year ago and has generally been flat over recent months. New home sales are slow, and prices remain generally stable. Lumber prices are up because of reduced cutting in the Northwest in recent months, but builders expect lumber prices to stabilize. For the rest of the year, housing starts and new home sales are expected to be similar to last year.

Most district savings and loans report deposit outflows over both the last month and the last year. Deposits are expected to stabilize soon. Demand for mortgage funds remains weak, and most respondents expect little improvement in upcoming months. Mortgage rates have been constant or up slightly at most institutions. There was no consensus on the future direction of mortgage rates--some respondents expect rates to rise while others expect rates to fall.

Banking. Most commercial bank respondents report that loan demand is up moderately over the last month. Increased demand is reported in all categories of loans: commercial and industrial, consumer, residential real estate, commercial real estate, and agricultural. None of the respondents report a change in their prime rate, and none expect a change in the near term. Nor do most report a change in consumer lending rates, although a few report lower rates. Virtually none of the respondents expect a change in consumer rates in the near term.

Changes in loan-deposit ratios and in deposit activity were mixed at district banks. IRA and Keough accounts were generally up, while MMDAs were

generally down.

Agriculture. Large amounts of spring rain across much of the district marked the end of the drought that gripped large parts of the region during the past two years. The plentiful rainfall has improved pasture conditions and generally boosted prospects for the winter wheat crop, but has delayed planting of spring crops in some areas. Planting is about seven to ten days behind normal in Oklahoma and three to four weeks behind normal in Missouri. Warmer weather will be needed to promote crop development.

The district's winter wheat crop is generally in good condition, although continued wet weather has contributed to disease problems in some areas and could delay the wheat harvest. The wheat harvest has begun in Oklahoma and will progress north across the district through mid-July. Expected yields range from average to well above average, with record yields likely in much of Kansas.

Improved pasture conditions, due to the plentiful rains, ensure an adequate feed supply for cattle herds. Although plentiful forage supplies encourage herd expansion, feeder cattle prices remain exceptionally strong. As a result, herd expansion is occurring at a slow pace.



## ELEVENTH DISTRICT--DALLAS

The District economy is growing slowly, but respondents remain optimistic. Manufacturing has shown little change recently. Growth in retail sales has softened. District auto sales are up slightly. Services activity is expanding somewhat. Construction contract values continue to fall. Oil and gas drilling firms remain optimistic about further growth. Agricultural prices lately have slipped a little, but remain well above a year earlier.

Manufacturing firms cite little overall change in orders, but survey responses vary widely among industries. Oil-field equipment sales growth is accelerating. Respondents expect further increases in sales in 1990. Steel firms note rising orders after a soft period in late 1989. They also say that selling prices have increased during the last two months. Reports by respondents in the fabricated metals industry vary widely but, on average, show little change. In the lumber and wood products industry, reports are mixed. Firms that serve national markets are seeing slowing homebuilding-related sales. Firms that chiefly serve District markets have seen growth lately. As a result of heavy spring rains, some lumber firms are having difficulty removing logs for cutting. Among stone, clay and glass producers, brick firms cite expanding orders. Cement firms express concern about sluggishness in state highway construction contracting while noting that demand has not changed. Electronics and computer-related firms say their commercial sales are generally increasing after a slump in late 1989, but that declines in defense sales and in sales to defense contractors have been more rapid than the firms had expected. Some of these respondents said that

reductions in orders from defense firms had resulted in overall dropoffs in orders. Among nondurable goods industries, apparel producers note slowing sales, and food-processing firms also note some decreases. Paper producers say that overcapacity in their industry, together with declines in demand, has motivated price reductions and that the high dollar has discouraged exports. Most chemical firms say that demand and prices for their products range from unchanged to slightly down, but that orders remain high and plants are mostly running at or near capacity. Refinery production has remained unchanged, but gasoline prices and profit margins are up.

Retail sales expansion shows signs of slowing, after strong growth early in the first quarter. But some chains say their District sales are still outperforming their national sales. After a very weak Memorial Day sales period, expansion rebounded somewhat, but the recent pattern of softness continues to concern some respondents.

District auto sales are up slightly over last year. In April, year-over-year growth was strong in Dallas, moderate in San Antonio and negative in Houston although Houston's January-April sales were 7 percent above last year. Sales of U.S.-built foreign brands have posted particularly high rates of expansion.

Service firms generally report some growth in demand, but responses are more mixed than in recent previous surveys. Labor contracting and temporary employment firms note some recent increases in overall demand, but they say that reductions in defense-related work in Las Cruces and White Sands, New Mexico have led to decreasing demand there. Most business service firms report that their sales are now fairly strong, and that they are cautiously

optimistic about expansion during the next two quarters, but that recent demand has not been great enough to allow most of them to raise prices. The exception within this industry group has been data processing firms, for which both demand and selling prices are up.

District construction remains weak. Nonresidential contract values have risen somewhat in recent months, but remain well below levels of late last year, while nonbuilding contract values have fallen sharply. Residential values have declined, but considerably less than nationally. They have actually increased in Houston and Dallas/Ft. Worth. These gains have been led by multifamily construction, which has grown in response to rising apartment rents and occupancy rates. Occupancy rates in major office markets are also increasing, but remain low.

Although oil prices have fallen in recent months, the District energy sector continues to expand. In May, the District rotary rig count was up 44 percent from a year earlier. During the past several months, employment in oil and gas extraction has rebounded. Most respondents offer favorable outlooks for long-term oil prices, but one noted that oil prices may be set for another big drop in the near term. Natural gas prices are generally expected to rise.

In District agriculture, water has been a concern lately. Heavy spring rains impeded normal planting patterns, but recent warm temperatures have dried topsoil sufficiently to permit seeding. Receding flood waters along the Trinity River are leaving behind heavy losses. Prices received by farmers and ranchers in May were 1 percent below April levels, but remained 8 percent above a year earlier.

## TWELFTH DISTRICT -- SAN FRANCISCO

Summary

Economic activity in the West continues at a healthy level. Western business leaders continue to anticipate relatively slow growth during the next twelve months, although they are slightly more optimistic than they were six weeks ago. Overall wage and price trends have changed little during recent weeks, with increases averaging around 4 or 5 percent. Conditions in the trade and service sectors continue healthy, with little change reported. The pace of manufacturing activity varies widely within the District, with strength in aluminum, food products and commercial aircraft offset by weakness in defense industries and in some technology firms. Agricultural conditions in the West are satisfactory overall. The forest products industries face thinner margins. Most western real estate markets continue healthy. Recent reports confirm that lending standards have become more stringent in recent months, although the effect on credit-worthy borrowers is not clear.

Business Sentiment

Western business leaders continue to anticipate relatively slow growth during the next twelve months, although they have become slightly more optimistic during the last six weeks. Three-quarters of respondents continue to expect that GNP growth will be positive but slower than 2 1/2 percent, while the proportion anticipating growth in excess of 3 percent rose from zero to four percent. Expectations regarding business investment, consumer spending, and the trade balance improved somewhat, while deterioration was noted in expectations regarding housing starts.

Wages and Prices

Overall wage and price trends have changed little during recent weeks, with increases in the 4 to 5 percent range remaining the "central tendency." Health care costs continue to rise at

double-digit rates. One respondent who runs a machinery repair shop reports that, although his wage rates have not changed, he recently raised his shop rates by more than 5 percent to cover increased medical costs. Substantial upward price pressure also is reported for some drought-affected agricultural products, including alfalfa and cattle. A recent labor settlement in Hawaii calls for wage hikes averaging 7 percent per year for the next 5 years.

In contrast, some other products are seeing flat or lower prices. Prices for lumber and wood chips have fallen sharply in recent months, squeezing profits as log prices remain high. A car dealer reports that there is downward pressure on the prices of new cars. Many clothing retailers reportedly believe that the recent CPI increase in women's apparel prices is spurious, since competition in the industry makes it unlikely that higher prices can be maintained.

#### Trade and Services

Conditions in the trade and service sectors are generally unchanged. Retail sales continue healthy overall. Department stores, as well as food and drug retailers, report good conditions. The number of visitors to Hawaii has recovered following a hotel strike earlier in the spring. However, District auto sales continue weak, with no sign yet of the usual spring sales pickup.

#### Manufacturing

The pace of manufacturing activity varies widely within the District. Aluminum smelters are operating at capacity, while production of food products and plastics is reported to be strong in the Northwest. Commercial aircraft production is limited by capacity constraints, although production and delivery rates continue to rise as labor productivity improves further. Reports from the Northwest indicate that products associated with high-end construction such as wood-frame windows and specialty finishes are in strong demand.

Reports of flattening or declining activity continue to be concentrated in the defense and technology sectors. Several defense firms in the West have announced layoffs in recent weeks,

and one large firm also has announced plans to move some of its operations from southern California to Georgia. The strength of commercial aviation, as well as possible increases in NASA funding, are the main bright spots for these firms. Overall conditions in technology-related sectors are relatively flat at present, but with wide variations by company and product line. One company supplying the computer industry reports very slow sales, but some firms in various segments of the electronics, computer, and software industries are doing very well.

#### Agriculture and Resource-Related Industries

Agricultural conditions in the West are satisfactory overall. Most farmers and ranchers have generated healthy profits in recent years, so their financial positions are relatively strong. Oregon vegetables are in strong demand by food processors, so plantings are up this year. Recent unseasonal rain storms in California provided enough water to increase allotments from their low drought levels. However, the storms also caused significant damage to some farmers' tree fruit crops.

Conditions in the forest products industries continue to deteriorate. More stringent restrictions on logging federal land have reduced the supply of logs and increased their price. At the same time, reduced home-building activity nationwide has weakened the price for finished lumber. The resulting profit squeeze has led several mills to lay off workers or close down entirely.

#### Construction and Real Estate

Conditions remain healthy in most western real estate markets. In California, the pace of home sales and the average amount of time on the market have returned to more "normal" levels. Average time on the market has risen in recent weeks in Washington. In both California and Washington, sales activity is stronger in the lower price ranges. Construction activity and the number of homes sold have risen by double-digit rates in Oregon, Idaho, and Utah. The average

amount of time on the market has fallen significantly in these three states. Despite the widely publicized problems in Arizona's real estate markets, home prices have remained relatively stable, with small declines in some categories offset by small increases in others.

#### Financial Sector

Reports from inside and outside the financial industries confirm that lending standards have become more stringent in recent months. However, the effect on credit-worthy borrowers is not clear. Some lenders report that they are no longer financing "marginal" deals, suggesting that credit-worthy borrowers are still able to obtain funds. In Arizona, however, it is reported that only builders with excellent records and significant equity can borrow. Car dealers express growing concern about tightened lending criteria and withdrawals by some lenders from the "dealer indirect" business. A developer notes that the impact of more stringent lending criteria will likely be seen in a year or two, when less new space comes on the market.