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Summary of Commentary on

Current Economic Conditions

by Federal Reserve District

November 1997

**SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICTS**

NOVEMBER 1997

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SUMMARY*

On balance, Federal Reserve Districts report a continued moderate pace of economic growth since the last report. Non-auto retail sales improved in most regions. While a number of Districts report that sales were still a bit below plan, retailers are generally optimistic about the sales outlook. Inventories are deemed to be in good shape. Automobile sales continued to be sluggish, with inventories on the high side. Manufacturers report continued high levels of activity, with some constrained by capacity limitations; contacts in the West and South report continued shipping problems due to rail bottlenecks. Asian financial turmoil and currency weakness have adversely affected demand for manufactured and agricultural exports, and some Districts report increased competition from imports. Residential real estate markets are mixed, but commercial real estate markets continue to tighten in most areas.

Virtually all regions are experiencing tight labor markets, with some reporting increased wage pressures in specific industries and occupations with labor shortages. Retailers are having a particularly difficult time in hiring and retaining seasonal workers. More generally, businesses are using a variety of nonwage incentives to attract and retain workers. Business respondents report that price pressures remain neutral, on balance, as steady to declining commodity prices, productivity gains, and increasing overseas competition appear to be offsetting any effects of wage gains.

Consumer Spending

Most Districts report that retail sales have improved since the last report, buoyed by the late arrival of winter weather in the eastern half of the country. Boston, Minneapolis, Kansas City, Dallas, and San Francisco report steady improvement, while New York, Philadelphia, Cleveland, Richmond, Atlanta, and Chicago note a weather-related rebound from the sluggish

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performance indicated in the last report. Inventories are reported to be in good shape in all parts of the country, with retailers in most regions expressing optimism about the sales outlook for the holiday season. However, New York reports that consumers are budgeting less than last year for holiday spending, and Boston notes that some retailers are concerned about possible fallout from the Asian financial market turmoil.

Automobile sales generally remain soft, with a corresponding rise in inventories. Overall, sales of light motor vehicles were sluggish in Philadelphia, Cleveland, Chicago, St. Louis, and Kansas City, though the latter three Districts report strong demand for sport utility vehicles.

Manufacturing

Manufacturers report high levels of capacity utilization, but a variety of supply and demand factors are constraining current output growth and future expansion plans. On the supply side, bottlenecks in rail shipments are cited by Atlanta, Dallas, and San Francisco; labor constraints are noted in Boston, Richmond, Atlanta, Minneapolis, and San Francisco. On the demand side, there is some concern about the fallout from Asian financial turmoil and currency weakness—with respect to both exports and competition from imports. Weakening Asian demand is noted in Boston, Philadelphia, Cleveland, Dallas, and San Francisco, while Atlanta reports that manufacturers have scaled back production levels in anticipation of softening sales to the Far East; on the other hand, Chicago notes that there has been no immediate impact from the events in Asia.

By industry, heavy equipment manufacturers and steel producers in Chicago and Dallas report strengthening demand. In contrast, demand for apparel, textiles and electronic equipment appears to be weakening in a number of Districts.

Construction & Real Estate

Commercial real estate markets continue to tighten, while residential markets are mixed but generally firm. Low and declining office vacancy rates have led to rising rents in New York, Philadelphia, and Atlanta, and have spurred increased construction in Philadelphia, Cleveland, Atlanta, Dallas, and San Francisco. Chicago, St. Louis, and Minneapolis report high, though not

rising, levels of construction activity.

Residential real estate markets are reported to be fairly strong in most Districts, though some recent slowing is noted in Atlanta, Kansas City, and San Francisco. Boston and Philadelphia report that demand has been strongest for higher-end homes, but Dallas reports a shift toward more starter homes. Atlanta, Chicago, St. Louis, Minneapolis, Dallas, and San Francisco report brisk homebuilding activity. However, Boston and New York note low levels of construction, despite recent strength in the market.

Banking and Finance

Loan demand is mixed but stronger, on balance, with strength in commercial loans more than offsetting some softening in the consumer segment. Kansas City, however, reports a pickup in consumer lending, and strong growth in commercial loan demand is reported from Philadelphia, Cleveland, and Atlanta. The only Districts to note softer loan demand overall are New York and St. Louis. Delinquency rates were little changed, on balance—Philadelphia and San Francisco report some deterioration in credit quality but New York notes improvement. Intense competition for commercial and industrial lending is reported in a number of Districts: Philadelphia, Cleveland, Richmond, Dallas, and San Francisco.

Nonfinancial Services

Tourism, including business travel, continues to boom along the Eastern seaboard regions. Boston, New York, Richmond, and Atlanta report that tourism remains exceptionally strong, with Boston and New York noting a shortage of hotel rooms and rising rates. In contrast, Minneapolis reports that tourism is one of the few weak sectors of late.

A number of Districts indicate ongoing strength in business services. Boston and Dallas report continued solid growth in the temporary employment industry; St. Louis notes strength in the gaming industry and mortgage and insurance claim processing; Minneapolis reports that computer consulting firms are “swamped with orders”; San Francisco reports strength in telecommunications and business services.

Labor Markets, Wages and Prices

All regions report tight labor markets. Boston, Richmond, Atlanta, and Minneapolis specifically note shortages of technical computer workers and engineers. More generally, temporary employment agencies in Boston, Cleveland, Richmond, Atlanta, and Dallas report strong growth in labor demand.

Wage pressures have increased somewhat but are generally isolated to a few industries and occupations with severe labor shortages. Boston, Richmond, Dallas, and San Francisco report increasing labor demand in the financial services sector, with some reports of increased wage pressures. Retailers in almost all Districts are having particular trouble hiring and retaining workers for the busy holiday season. While some retailers in Boston and Minneapolis have hiked wages, certain stores in the New York and San Francisco Districts have resorted to offering nonwage incentives, such as bonuses and steeper in-store discounts.

More generally, businesses are dealing with labor shortages in a variety of ways. Some are tapping broader geographic labor markets: Atlanta reports that shipyards are recruiting from overseas; Chicago cites businesses recruiting in nearby rural areas or relocating to the inner-city. Cleveland reports that firms are offering increased benefits and more flexible work rules, while retailers and banks in the San Francisco District are converting part-time to full-time jobs.

Despite the increase in wage pressures, prices for goods remain flat, although there are scattered reports of price pressures in areas such as commercial real estate and hotel lodging. Businesses report that steady to declining commodity prices, increasing competition from overseas and productivity gains appear to be counteracting effects of wage gains on selling prices for goods. In particular, Dallas and San Francisco indicate that the strong dollar has lowered import prices, and Cleveland notes that increased steel imports have held prices down. Boston, New York, Cleveland, Atlanta, and Kansas City indicate that finished goods prices are steady or down slightly, while Richmond reports modest increases.

Agriculture and Natural Resources

Favorable crop conditions are reported from most agriculture-intensive Districts—Cleveland, Minneapolis, Kansas City, Dallas, and San Francisco. However, heavy rain caused

delays in fall planting and harvesting of wheat, barley and oats in Richmond and cotton in St. Louis. Rail disruptions were reported to be minimal in the St. Louis District, but some problems related to the handling and storage of perishable crops were cited by San Francisco. Minneapolis reports that grain producers in North Dakota have been hurt by severe plant disease problems. Livestock conditions are also said to be generally favorable in Richmond, Minneapolis, Kansas City, Dallas, and San Francisco. Only San Francisco and St. Louis indicate some adverse impact from the Asian currency crisis on agricultural export demand.

Dallas reports “extremely high levels” of activity and labor shortages in the oil services sector, while Minneapolis notes a boom in gas and oil development. Kansas City reports that energy-sector activity has recently declined but remains above year-ago levels.

FIRST DISTRICT - BOSTON

The First District economy continues to expand at a moderate pace. Sales and revenue gains are reported to be healthy, but manufacturers and retailers express concern about whether the current pace of activity is sustainable. Prices are said to be generally flat, although wage pressures are increasing in some submarkets. Contacts say the residential real estate market is performing well.

Retail

Most retail contacts report that sales continue to grow at a moderate pace in the current quarter. Areas of strength are building supplies, tourism, office and graphic reproduction supplies, and home furnishings, all of which are said to be growing at a 10 to 20 percent pace. Areas of weakness are apparel sales and discount retailing. Across the board, sales growth is said to be at or slightly above expectations, with inventories at desired levels.

Employment is reported to be either increasing moderately or holding steady. Contacts mention pockets of tightness in labor markets, most notably the faster-growing sectors. In these submarkets, significant wage premiums are being offered to attract labor from competitors. In contrast, contacts that are mainly hiring for normal turnover report little difficulty in attracting help. Wages are generally said to be increasing at a 3 to 5 percent annual rate.

Respondents indicate that most prices are holding steady because of an extremely competitive retail environment. The exception is tourism, where rates are rising to ration the short supply of hotel rooms. Materials costs are said to be unchanged. Contacts say that profit margins are either level or increasing slightly because of efficiency improvements that outweigh wage increases. The two exceptions are office/graphics supplies and tourism; hotels are realizing increases in profits as prices rise, while office supply stores report wage-driven declines in profitability.

Most contacts plan modest capital expansions for 1998. Looking forward, retailers expect moderate growth continuing through the first quarter of 1998. However, a significant minority of retailers mention

the possibility of the stock market and international events negatively affecting growth prospects for next year.

Manufacturing

Three-quarters of First District manufacturers contacted report that recent business is unchanged or up at a single-digit rate compared to a year ago. Most of the remaining firms cite revenue or order gains in the range of 10 to 20 percent. Although manufacturers are continuing to experience strong trends for furnishings, some computer products, and aircraft parts, a number of contacts are disappointed by recent demand for electrical, electronic, consumer, and medical goods. Contacts report a slowdown in Asian sales; demand generally continues to grow in other export markets, but revenues are down in dollar terms. Holiday sales in the U.S. are expected to be solid but not outstanding.

Manufacturers indicate that most materials costs are flat to down. However, high-grade lumber prices are considerably higher than a year ago and expected to increase further as a result of strong demand. Contacts are also paying higher prices for packaging, upholstery materials, and natural gas. Only one contact (a manufacturer of upscale furnishings) has implemented a meaningful increase in selling prices. The remainder report that selling prices are flat to down as a result of competition, resistance on the part of retail chains, or productivity gains. A sizeable minority express concern that competition will exert further downward pressure on prices.

With some exceptions, employment at respondent firms is holding steady. Manufacturers are experiencing very tight labor markets for information technology and engineering positions, as well as some shortages of production workers in rural areas. Average pay is said to be rising at a rate of 3 to 6 percent, with greater increases for some technically-oriented and senior professional categories.

On the whole, projections for 1998 are somewhat guarded. Some manufacturers foresee revenue growth in the low single digits. Others expect better results but most hasten to add that rates of growth are unlikely to match this year's performance.

Temporary Employment Firms

Expansion in the temporary employment industry continues. Most contacts report revenues to be growing 14 to 40 percent annually. Temp labor markets are said to be extremely tight across all industries and occupations, with the exception of low-skilled entry-level workers. However, respondents cite little or no effect on wage growth, which continues to range between 3 and 10 percent annually. Some contacts note their profit margins are being squeezed, primarily because of increasing price competition; others say prices are rising in line with wages. Many mid-size firms are merging or being acquired. Smaller agencies reportedly avoid competition with large "one-stop shopping" firms by specializing or operating as secondary vendors.

Residential Real Estate

The residential real estate market in New England is doing well. Contacts report active markets with moderate increases in sales and little, if any, price pressure. Relative to a year ago, third quarter sales were slightly lower in Vermont, but up in Connecticut and Massachusetts. Rhode Island and Maine experienced minor changes in sales. Only Massachusetts contacts report price increases for existing homes. Several respondents say existing homes are in short supply, but some also note excess supply of new homes. There has been little speculative new construction, even though high-priced new homes are selling well.

Nonbank Financial Services

In September and October of 1997, cash flows into mutual funds continued at a robust pace. Because of recent market volatility, October cash inflows were 19 percent below September's, but still 50 percent greater than in August. Latin America and Asia/Pacific funds report net cash outflows in the past two months. This cash is said to be flowing into domestic stock funds. Assets in Asia/Pacific funds have dropped by half since August because of cash outflows and the drop in their market value. Respondents at local investment management firms indicate that they are increasing employment because of the growing volume of business and plan to increase employment further during the rest of the year.

SECOND DISTRICT--NEW YORK

Most reports in recent weeks show the Second District economy maintaining a steady pace of growth. Major retailers report that sales were mixed but, on balance, below plan in late October and early November, though some note a modest pickup by the middle of the month; retail selling prices, merchandise costs and wages remain flat. The housing market maintained a positive tone across most of region. The New York City area's increasingly tight commercial real estate market has pushed up office rents, while a shortage of hotel space in Manhattan has caused a sharp rise in room rates. Regional purchasing managers' reports indicate steady growth in manufacturing activity but little in the way of price pressures. Finally, local banks report some softening in loan demand—especially for home mortgages—and falling delinquency rates in all categories.

Consumer Spending

Major retailers offer a mixed assessment of sales performance during late October and early November. At major discounters, same-store sales were up 6-8 percent from a year earlier, and above plan. However, traditional department stores report that comparable-store sales were little changed from a year ago and generally below plan, though most contacts note some improvement in mid-November. They also emphasize that sales have improved from the dismal levels recorded in September and early October. All contacts say that inventories are in good shape—even those with sluggish sales. Retail selling prices, merchandise costs and wages are all reported to be flat. Most contacts indicate that finding and retaining holiday-season workers has been more difficult than a year ago; one contact notes that rising wages have been fully offset by productivity gains; the rest have not seen any measurable rise in wages. However, some smaller retailers in New Jersey are offering larger in-store discounts and bonuses as incentives.

Recent surveys conducted by the Conference Board suggest a mixed outlook for holiday

spending. Consumer confidence in the Middle Atlantic states (New York, New Jersey, and Pennsylvania) rose to a cyclical high in October; it retreated modestly in November but is still sharply higher than a year ago. However, in response to a supplementary question posed every November, consumers in the region say they are budgeting less for holiday spending, on average, than last year.

Construction & Real Estate

The region's housing market remains fairly strong. New Jersey homebuilders report that new home construction remains at a low level, due largely to supply constraints. Due to the high cost of land, new construction is increasingly restricted to the high end of the price range, pushing up the median price of a new home. Contacts report that the resale market continues to gain momentum, with prices appreciating at a 6-7 percent annual rate, led by the high end. New York State realtors report that existing-home sales picked up slightly in September, running 5-6 percent ahead of a year ago; home prices continued to run 4-5 percent ahead of a year ago, with modest declines upstate offsetting rapid appreciation in the New York City area.

Office markets in New York City and northern New Jersey continue to tighten, as a shortage of available space appears to be boosting rents. Midtown Manhattan's office availability rate (space coming available within the next six months) declined to 10.3 percent at the end of October, from 10.7 percent a month earlier. Downtown's rate tumbled to 17.7 percent from 18.9 percent—strong leasing activity, largely from the financial sector, combined with commercial-to-residential conversions has pulled a substantial amount of office space off the market in recent months. Builders in New Jersey report that the market for Class A commercial space is “tight as a drum”, with virtually no large space available; moreover, this strength is spilling over into the Class B market and boosting rents in both segments. One contact notes that landlords now have pricing power for the first time in eight years.

In the Buffalo area, a number of large public sector-driven construction projects are reported to

be in the pipeline, including a convention center and a zoo downtown, as well as a few large renovation and redevelopment projects; altogether, an estimated \$580 million in public funds will be used.

Other Business Activity

Regional purchasing managers report continued strength in the manufacturing sector, along with subdued price pressures in October. New York purchasing managers report strong growth in both the manufacturing and non-manufacturing sectors in October, along with a moderate increase in price pressures. Buffalo purchasing managers report steady growth in new orders and production activity, but little change in employment and prices. Rochester purchasers report steady improvement in general business conditions, along with a slight increase in price pressures. Rochester-based Eastman Kodak confirmed expectations that it will cut 10,000 jobs over the next two years and take a \$1 billion charge in the fourth quarter; it is estimated that roughly half the job cuts will be in the Rochester area.

In New York city, tourism and business travel continue to boom. Hotel occupancy rates remained close to 85 percent in the third quarter. Meanwhile, room rates surged 13 percent in September (seasonally adjusted), and were up 14 percent from a year earlier.

Financial Developments

Bankers at small and medium-sized banks in the District report weaker demand for loans since the last report. In particular, demand for residential mortgages, nonresidential mortgages and consumer loans declined, while commercial and industrial loan demand remained stable.

Bankers' credit standards across all categories remained the same. Interest rates on all types of loans declined—especially mortgage rates: 45 percent of banks report a decline in residential mortgage rates and 53 percent report lower nonresidential rates. Deposit rates, however, continued to increase, on net. The quality of credit improved, as reflected in falling delinquency rates across all categories.

THIRD DISTRICT - PHILADELPHIA

Economic conditions in the Third District were improving modestly in November. Manufacturers' shipments and orders were moving up slightly. Retail sales have shown only slight improvement since October, with the increase primarily in apparel. Auto sales have been steady, but dealers' inventories remain high. Bankers generally noted some recent increases in borrowing by both businesses and consumers. Commercial real estate markets continued to tighten; office vacancy rates have declined slightly since mid-year, and construction of office and industrial buildings has increased. Home builders and residential real estate agents reported that demand for both new and existing homes has been healthy in November.

MANUFACTURING

Manufacturing activity in the Third District expanded modestly in November, according to reports from industrial plants in the region. Around one in four of the companies contacted indicated that shipments and orders increased during the month; around one in five noted declines. Overall, order backlogs at firms in the District continued to drop. Producers of textiles and apparel noted slower business. Although some firms said this was a normal seasonal pattern, a few said they have been seeing falling demand for their products. Some companies that manufacture capital goods reported that the strength of the dollar and increased uncertainty in Asian markets have had a negative impact on their foreign sales. Producers of metals and metal products also noted slipping sales. In contrast, manufacturers of chemicals, machinery, and instruments said demand has picked up. Several firms in these sectors were increasing capital

spending to add capacity.

Industrial prices remained steady at three-fourths of the firms contacted for this report. The number of companies noting increases, for both input costs and output prices, slightly exceeded the number reporting declines. Some companies commented that the magnitude of the increases was slight.

RETAIL

Retailers gave mixed reports for November. With the onset of cold weather, department and apparel stores had slight improvements from October. Stores specializing in hard goods and home furnishings had only steady sales, at best. Merchants have announced sales to prod early holiday shopping. Forecasts for the Christmas shopping period vary; on balance, store executives believe sales this year will probably be better than last year, but only by a small amount.

Auto dealers reported that sales have been running at a steady pace in recent weeks. The sales rate has been below dealers' expectations, however, and inventories have risen above desired levels. Manufacturers' rebates and financing incentives have been increased.

FINANCE

Loan volume outstanding at major Third District banks picked up slightly in November after being flat in October, according to lending officers contacted for this report. They indicate that companies in most of the region's industries have been seeking modest increases in financing to support growing business. Several banks noted that borrowing to refurbish and modernize office and retail facilities has increased significantly. Nonetheless, bankers continue to describe commercial and industrial lending as very competitive. Consumer lending, which

slowed in October, was increasing in November at most of the banks surveyed. Bankers remain concerned, however, that the upward trend in consumer loan charge-offs has not yet peaked.

REAL ESTATE AND CONSTRUCTION

Commercial real estate agents reported an improvement in sales and leasing activity in the third quarter. According to one recent market survey, the office vacancy rate for the Philadelphia area, including southern New Jersey and northern Delaware, dropped from 12.6 percent at mid-year to 12.2 percent at the end of the third quarter. The vacancy rate in Philadelphia's central business district was relatively unchanged. Vacancies did decline in suburban markets around Philadelphia, and office construction activity increased in suburban markets. Rents for Class A space in the Philadelphia region as a whole moved up a bit. The vacancy rate for industrial buildings in the region increased to 13 percent at the end of the third quarter from 10 percent at the end of the second quarter, but real estate agents said the availability of modern facilities remains tight, and rents have increased slightly. Construction of industrial buildings has increased.

In general, residential builders reported healthy sales in November equal to the year-ago pace or higher. They also indicated that prices have increased. Customer traffic has been high at new residential developments and construction backlogs have been rising. Residential real estate agents indicated that sales of existing homes have been good and that the supply of homes for sale has declined. Demand has increased relatively more for newer, existing homes and homes in the higher price ranges than for older and less expensive homes. Overall, real estate agents said price appreciation for existing homes has been slight

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FOURTH DISTRICT - CLEVELAND

General Business Conditions

The Fourth District economy continues to grow at a moderate to good pace. Labor markets are strong, and price pressures remain light. Residential and commercial construction is very active in the District, with sales and prices rising in both markets (particularly in central Ohio).

District retailers indicate difficulty finding seasonal workers, although no more so than in recent years. One notable exception appears to be in central Ohio, where reports of more extreme labor shortfalls are heard. Temporary employment agencies note a further rise in the already heavy demand for workers, especially clerical help and general laborers. Only a few sources report increased wage growth, although a number of firms are offering increased benefits and more flexible work rules.

Manufacturing

Industrial activity has strengthened considerably since summer. Orders growth has been good, production and employment levels are increasing, and inventories are shrinking. Moreover, order backlogs are rising again, and some shortage of skilled workers is seen. Steel producers indicate good orders growth from a variety of sources, although additions to capacity and an increase in steel imports have helped to hold price increases down. A similar report is heard in heavy truck manufacturing, where production and order levels have reached or surpassed the historic peaks of 1995. The order books in this industry look solid through early 1998, and little, if any, price pressure is noted.

Firms with significant sales in Asia have seen a falloff in orders recently. In particular, orders for semiconductor manufacturing equipment declined substantially between August and October.

Consumer Spending

Retailers in the District report that unseasonably warm weather during the first two weeks of October restrained spending a bit. However, sales have recovered and are currently at, or slightly above, retailers' expectations. The recent sales growth has been broadly based, but is particularly strong in domestics (linens and towels), certain apparel lines, and electronics, including personal computers.

Retailers surveyed indicate that year-over-year sales are currently running about 3% to 5% above last year's level, with a few reporting substantially higher growth rates. Inventory levels are thought to be adequate for the season, although a strong holiday sales period is generally anticipated. Retailers continue to report steady prices. In some cases, wholesale costs actually seem to be falling.

Auto sales in early November continued a string of generally soft reports that began in September, and many dealers expressed concern over their growing inventories. Price incentives are reported to be on the rise. Sales activity in the used car market is seen as especially slow, and deep price discounts are being offered.

Agriculture

Overall, crop conditions have been favorable this year. Combined corn production for Ohio, Pennsylvania, and Kentucky is expected to exceed last year's level by 18%, with yields much stronger in Ohio than elsewhere in the District. The region's

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soybean crop is projected to be 22% above 1996's harvest. Again, yields are slightly higher in Ohio than elsewhere. Soybean prices fell between September and October, while corn and hay prices firmed a bit.

Kentucky tobacco production is expected to be 8% higher than last year, down slightly from preliminary projections. The quality and condition of the crop are variable, and there is some concern about poor color and weight.

Major auctions during the first two weeks of November suggest a strong demand in the District's horse farm industry. At one auction, more than 2,000 horses were sold over the period and gross sales topped \$200 million, a record high. Dealers and breeders report that the improved numbers are due to high stock quality and a healthy domestic economy. Selling prices, while strong, were not judged to be unusually high.

Banking and Finance

Lending activity in the District is strong overall, with commercial loan demand continuing to grow, while a few banks are reporting a slight softening in consumer loans. A recent drop in mortgage interest rates has spurred a sharp rise in mortgage refinancing. Consumer delinquencies have recently leveled off, and a few banks indicate that they may be seeing some improvement.

The spread between borrowing and lending rates remains narrow, and competitive pressures are still reported to be fierce. A few banks note that competitive pressures have prompted an easing of commercial credit standards.

FIFTH DISTRICT-RICHMOND

Overview: Most sectors of the District's economy continued to expand moderately in late October and November, and growth picked up noticeably in a few sectors. Retail sales grew faster after September's lull. Manufacturing output increased; however, the rate of expansion was tempered by a slowdown in some industries. In the financial sector, District banks indicated that demand remained strong for all loan categories. Activity in residential and commercial real estate changed little, although commercial contacts in a few areas reported heightened development and investment. Labor markets tightened further but, outside of the service sector, only scattered reports of higher wage growth were received. Prices for goods and services increased at slightly faster rates.

Retail: Retailers in the Fifth District reported that sales strengthened during October and early November, driven by stronger-than-normal sales of fall and winter apparel. In addition, there were scattered reports that customers were taking advantage of well-stocked stores to shop early for the approaching holidays. Seasonally-adjusted employment in the retail sector continued to edge lower, although the decline was more moderate. Despite widespread reports of labor shortages, wage hikes were somewhat less pronounced than in September. Retailers indicated that prices rose slightly faster than indicated in our last report.

Services: Activity in the service sector expanded at a slightly lower rate since September. Real estate and wholesale trade revenues increased more slowly, while those for health service providers increased more quickly. Employment growth in the service sector remained steady. Sources reported heightened wage pressures, especially in financial services. Contacts continued to expect stronger demand for services in coming months. Compared to

September, prices in the service sector grew at a slightly higher rate.

Manufacturing: District manufacturers continued to post strong growth since our last report. The volume of new orders expanded at a somewhat more moderate pace, while that of shipments generally grew more briskly. Nevertheless, producers of electronic equipment, paper products, and furniture reported decreased shipments. Shortages of skilled workers continued to hamper manufacturing activity; wage growth remained strong. Both raw materials and finished goods prices rose at slightly higher rates than in September.

Tourism: Tourist activity continued to strengthen during October and early November. Several sources said that increased convention bookings helped boost growth in their areas, while others attributed growth to a lengthening of the post-summer season. One Virginia Beach hotelier indicated that his normal fall discounts had been reduced, and contacts at many other coastal hotels and restaurants told us that they had extended their season this year. Some sources said that holiday bookings had not lived up to those of a year ago. Nevertheless, contacts were generally optimistic that bookings soon would pick up and that activity in coming months would be above normal. Hotel and restaurant prices were little changed since our last report.

Ports: Activity at District ports strengthened. Increased agricultural commodity shipments pushed exports higher, while inbound shipments of metals and ores boosted imports. A North Carolina contact reported that shipments of wood chips from his port declined because of a strike at a Canadian paper mill.

Temporary Employment: Employers made greater use of temporary employment agencies during October and early November. Shortages of workers, especially those with computer training, were widely reported. According to one agent in Charlotte, N.C., recruiters

were taking advantage of recently announced layoffs to enlist workers with proven computer experience. Other sources indicated that employers were screening applicants more carefully after being “seriously burned” by poor performances of some recent hires. Wage pressures remained largely in check.

Finance: District banks reported little change in lending activity since our last report. Demand for consumer, commercial, and mortgage loans remained generally strong, but funds remained ample. A North Carolina banker said, “there is more money available now than I’ve seen in many years.” Several bankers noted that profit margins in commercial lending continued to be squeezed by competitive pressures.

Residential Real Estate: Residential real estate activity remained healthy across the District during late October and November, although home sales waned in some localities. A Charlotte, N.C., realtor characterized the market in his area as “steady, but not a rocket ship.” Homebuilders generally reported little change in housing starts and building permits; several contacts commented that low interest rates were helping to maintain the current level of activity. A Baltimore, Md., contractor noted “more competition and tighter margins” in the housing market there.

Commercial Real Estate: In recent weeks, commercial real estate activity changed little in most areas, but picked up in South Carolina and suburban Washington, D.C. Realtors in Columbia, S.C., cited a spate of commercial property sales to institutional investors. Institutions have recently purchased four large office buildings in Columbia’s downtown business district. Contacts also noted strength in the office sector with one realtor in Washington, D.C., reporting that vacancy rates there had fallen to nearly one percent. Despite the large demand, there was

virtually no new speculative construction. The current level of commercial rents concerned a Richmond, Va., contact who, believing that retail rents are “too high, [doesn’t] see how people are going to afford them.”

Agriculture: Rains in recent weeks delayed fall planting and harvesting activity across much of the District, according to agricultural analysts. Inadequate time between rains limited farmers’ ability to get into their fields. Wet weather delayed the sowing of winter wheat, barley, and oats. Soybean harvesting activity was behind schedule in many areas, and some farmers reported yield reductions because of deteriorating crop conditions. In addition, cotton producers expected a reduction in the quality of their crop. On a positive note, the rains improved pasture conditions and reduced the current need for supplemental feeding of livestock.

SIXTH DISTRICT - ATLANTA

Summary: The Southeastern economy continues to expand moderately in mid-fall, according to most contacts. Retail sales exceeded last year's levels, while home sales and construction varied across the District. Manufacturing activity has changed little and the outlook remains generally positive. The tourism and hospitality sectors continue to post strong numbers, and overall loan demand has increased slightly throughout the Southeast. Despite continuing reports of labor shortages, escalating wages remain isolated to only a few industries.

Consumer Spending: Most District retailers reported that sales in October exceeded year-ago levels slightly. Several retailers noted that overall sales improved with the advent of cooler temperatures during the last half of the month. Early November sales results have been spotty. However, many retailers report that recent sales have met their expectations, and inventories are generally appropriate. Apparel sales have strengthened since our last report, while home-related product sales have softened. Looking forward to holiday sales, most retailers continue to be optimistic. Many retailers expect that big-ticket items and better brands will do extremely well during this holiday season. Generally, retailers expect moderate levels of discounting. Most retailers report that it is extremely difficult to employ and retain good personnel for the holiday rush.

Construction: Reports from contacts indicate that recent home sales and construction have varied by area. However, on a year-over-year basis the single-family market weakened somewhat from October to early November. The majority of Realtors continue to report that home inventories and new home construction are balanced, but a growing number, especially in Tennessee, note rising inventories. Builders across the region continue to report that construction is flat to down compared

with last year. Realtors expect home sales will be similar to last year during the fourth quarter, while builders expect construction activity will decline.

District commercial real estate markets remain healthy. Most suburban and central District office markets continue to report rising occupancy and rental rates. A good deal of speculative construction is underway. Retail construction continues to be dominated by grocery store chain expansions and the move by retailers into secondary marketplaces. Multifamily construction has begun to decline in many parts of the District in response to higher vacancy rates and the presence of leasing concessions in several key markets.

Manufacturing: Manufacturing activity was little changed for the current reporting period and the factory outlook remained positive. Several contacts noted that their companies are increasingly investing in ways to promote efficiency, such as using information technology to predict production needs and purchase inventory. Increasing activity in the Gulf of Mexico's petroleum industry is boosting demand for regional firms producing energy extraction equipment. Less positively, the workweek is decreasing and factory payrolls are contracting for some producers of industrial machinery and textiles. One contact notes that Far East financial market disruptions are expected to adversely impact his electrical equipment sales and orders within the next few months. Some Southeastern manufacturers have been negatively impacted by problems in rail transport caused by the merger of the Union Pacific and Southern Pacific railroads.

Tourism and Business Travel: The tourism and hospitality sectors continue to post strong numbers and the outlook remains positive. Local tourism organizations expect theme parks in central Florida to have above-average attendance for the holidays. The recent announcement of a large expansion by Universal Studios should further stimulate central Florida's tourism industry.

South Florida hotels and resorts report high occupancies and strong advance bookings. Tourism from South America and Europe has been especially strong, with guests reportedly staying a day or two longer than last year. Contacts note that destination hotels in Miami will be packed through the winter season. Cruise demand is at high levels with stable pricing. A drop-off in convention business that led to low hotel occupancy in New Orleans has apparently reversed itself with improved bookings.

Financial: Most banking contacts throughout the Sixth District report that overall loan demand has increased slightly. Consumer loan demand remains flat, and automobile loan demand is mixed. Commercial lending remains strong, mortgage demand has increased. Loan quality varies across the District.

Wages and Prices: Although a continuing labor shortage is adversely affecting parts of the region, reports of escalating wage pressures remain isolated to a few industries. Some contacts, mostly retailers, are concerned about a shortage of holiday workers. A temporary agency reports that their recent orders for holiday help are surpassing last year's. The boom in casino and industrial construction has reportedly compounded the Gulf Coast's shipyard worker shortage by absorbing skilled workers; yards are resorting to bringing in skilled workers from overseas. One large chemical plant in the region was forced to curtail its expansion plans because of a dearth of skilled workers. Increasing wage pressures were noted by regional firms bidding for specific technical workers, such as computer programmers, systems analysts, or those with shipbuilding or energy extraction skills. The competitive environment and consumer bargain hunting continue to hold down attempts to raise materials and finished goods prices.

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SEVENTH DISTRICT--CHICAGO

Summary. Economic conditions in the Seventh District remained very similar to those cited in our last report, according to most contacts. Retail sales picked up in recent weeks as colder weather set in, and most contacts expected the holiday season to be good. Construction and housing activity remained strong, buoyed by low interest rates and readily available funds. Strong new orders continued to keep the District's manufacturing industries running near capacity. Overall lending activity remained robust, though there was some softening noted on the business side in some areas. Labor markets were still very tight, yet wage pressures remained subdued. Farmland values continued to rise, while farm credit conditions were mixed. Contacts throughout the District indicated that there was no immediate impact resulting from the financial turmoil in Southeast Asia.

Consumer spending. Overall consumer spending by market segment was mixed heading into the holiday season, though the onset of colder weather has helped increase sales in recent weeks. Most contacts reported that same-store sales gains were running in the low single digits over last year and one described results as "ho-hum." One retailer suggested that sales strength varied by market segment, with discounters showing the most strength, luxury stores strengthening, and middle-market merchandisers doing okay. Overall apparel sales were generally described as "on plan," having picked up as colder weather arrived in late October and early November. Cold weather also boosted sales of seasonal items. A few of the major chains reported strengthening sales of big-ticket items, such as electronics, appliances, and furniture. Inventories were reported to be in better shape than at the same time last year and, as a result, none of the merchants contacted were planning on increasing promotional activities. Most retailers were expecting a good holiday sales season, while their major concern continued to be the availability of seasonal workers. District dealers noted some softening in auto sales, while light trucks were reported to be selling well.

Housing/construction. Overall construction activity remained strong and most contacts reported that conditions were nearly the same as a month or two ago. One large realtor in the Chicago metropolitan area noted that resale strength continued to surprise on the upside. Sales

VII-2

had picked up throughout the third quarter and, by October, were off last year's very high levels by only 1 percent on a year-to-date basis. This contact pointed to low mortgage interest rates and the availability of funds as key drivers of the market. The downtown housing market in Chicago continued to boom, led by strength in condo conversions. Existing home sales tapered off in Michigan, according to one contact, who pointed to the unseasonably cold weather as a contributing factor. New home construction in the state had also slowed from last year's very high levels, but to "a much more comfortable pace for everyone," according to one analyst. Commercial construction activity remained very strong in most of the District, yet there were some reports of slowing growth. Several contacts indicated that the pricing and availability of funds continued to make commercial developments attractive.

Manufacturing. Reports on manufacturing activity were essentially the same as in our last report -- production levels remained very high, new orders continued to be strong, inventories were lean, and upward price pressures were subdued. Steel producers are expecting 1997 to go down as a record shipment year. Despite new capacity coming on stream recently, the industry continues to operate near capacity and order books are full through the end of the year. The strength in steel demand was broad-based, with notable orders coming from the construction and plant and equipment segments. Producers of heavy equipment (land-moving, agricultural, heavy trucks, etc.) were very optimistic heading into the new year with domestic shipments picking up and exports to Canada strengthening. New orders remained strong and the general feeling among contacts was that inventories were slightly low and backlogs high. One large producer of agricultural and construction equipment reported that the company was at capacity and running "all out." Automobile manufacturers indicated that overall demand remained strong and was holding steady. One automaker reported that its inventories were lean, but industry-wide stocks were generally at desired levels. The pricing environment remained very competitive in most manufacturing industries. Despite strong demand and plants operating near capacity, prices of most steel products were below last year's levels. Automobile manufacturers reported that new model sticker prices were flat and they were using more incentives than they anticipated a few months ago.

VII-3

Banking/finance. Overall lending activity remained strong in October and early November, though there was some slowing of growth reported on the business side. Most contacts reported that business lending continued to increase, but growth fell below some lenders' expectations. One large bank reported an uptick in merger and acquisition activity. There was reportedly no change in asset quality of business loans. On the consumer side, falling mortgage interest rates have prompted a mini-boom in refinancing activity in recent weeks. Rates on 30-year fixed-rate mortgages dropped below 7.5 percent in the region, the lowest level since early 1996. Personal bankruptcies stabilized over the last two months, but at high levels.

Labor markets. The District's labor markets remained very tight, with few new reports of intensifying wage pressures. The general consensus among contacts was that there was little discernable change in labor market conditions in October and the first half of November. Most retailers continued to express concerns about the availability of holiday help. Small businesses were becoming increasingly creative in their recruiting efforts. One contact noted that small businesses in one metro area were recruiting in nearby rural communities where labor markets were not as tight. An analyst in Wisconsin reported that a small manufacturer (100 employees) was planning on closing its plant in a tight labor market area and reopening in Milwaukee's central city, in hopes of being able to find workers at reasonable wage rates. The practice of temporary help firms recruiting through state employment agencies was becoming more widespread. The few new reports of intensifying wage pressures were confined to areas where severe worker shortages existed in occupations particular to those areas.

Agriculture. Our latest survey of agricultural bankers found that farmland values continued to rise in most areas of the District this summer, culminating in an average gain of 7 percent for the year ending October 1. The bankers expected gains to continue this fall and winter because of stronger demand to acquire land, both among farmers and nonfarmer investors. Agricultural credit conditions varied across the District but, in general, appeared to have tightened somewhat. Farm loan demand was up from year-earlier levels in most areas. However, the funds available for making farm loans tightened, partly reflecting "higher-than-desired" loan-to-deposit ratios at many banks. Farm loan repayment rates slowed somewhat, especially in areas hard hit by the squeeze on dairy earnings.

EIGHTH DISTRICT - ST. LOUIS

Summary

The District economy continues to grow at a steady pace. District retailers report moderate sales growth during September and October, but are expecting a strong holiday season. General business contacts remain optimistic, seeing relatively strong sales and demand growth despite increasingly tight labor markets. Some building wage pressures have been noted. Residential construction picked up somewhat in many District metropolitan areas in September. Loan demand, although still moderately strong, appears to be softening. Rainfall reportedly continues to slow the cotton harvest in parts of the Delta. The Union Pacific rail disruption is affecting mainly Arkansas.

Consumer Spending

Retail contacts generally report sales growth in the neighborhood of 3 to 4 percent in September and October compared with a year earlier. Inventories are at desired levels, so greater-than-usual discounting has been unnecessary. Most retailers anticipate a strong holiday season this year, surpassing sales of previous years.

On average, car dealers report that sales were up about 1 percent in September and October over a year earlier. Most dealers are offering rebates to help compensate for the sluggish sales. Contacts also note that, while demand for sport utility vehicles is strong and rising, the market for minivans seems to have dried up. Overall, contacts are expecting sluggish sales to persist through the end of 1997, and are approaching the first quarter of 1998 with guarded optimism.

Manufacturing and Other Business Activity

District contacts remain optimistic about economic conditions, although many continue to have difficulty finding qualified workers. Some contacts, especially retailers, have noted recently

that labor market conditions have tightened more, putting a squeeze on merchants just before the holiday season. In some instances, contacts have reported increasing wage pressure along with the tighter labor markets. But most contacts are planning for a “usual” 4 percent salary increase in 1998.

Sales remain strong, and many manufacturers expect to hire additional workers to meet the increasing demand. Ford, for example, is expanding its truck production in Louisville, creating about 1,000 new jobs. Processing centers for mortgages and insurance claims are opening or expanding, bringing 200 jobs to St. Louis and almost 400 jobs to Louisville. The gaming region of northwest Mississippi will employ 15,000 by the end of this year, and expectations are that it will add another 1,800 workers next year, although it is unclear where the workers will come from.

The District’s apparel industry sustained several new blows. After letting 2,000 workers go from two Kentucky plants this past August, Fruit of the Loom has announced that another 1,000 will be let go from the same two plants; production is moving overseas. And because the demand for jeans has dropped so much, Levi Strauss will close two plants in Arkansas, eliminating 675 jobs.

Real Estate and Construction

Monthly residential construction permits in September picked up in nine of the District’s 12 metropolitan areas, a turnaround from earlier reports when only two or three metro areas showed gains. Year-to-date permit levels, however, were still below last year’s levels in nine metro areas. Nonresidential construction remains strong in many parts of the District, especially in northern Mississippi where public school renovation and university student housing construction are quite active.

Banking and Finance

Loan demand appears to have eased somewhat over the past several months, according to contacts at several mid-sized District banks. Nevertheless, contacts still describe demand as moderately strong. Consumer loan demand appears to have softened the most, although contacts expect some rebound because of the holiday season. Business loan demand has also softened in recent months. Credit quality is still very high, and a number of banks expect record earnings again this year. Deposits are still hard to come by, and many banks continue to seek other funding sources.

Agriculture and Natural Resources

Favorable weather during much of October compressed this fall's harvest schedule in many areas. In the Delta region, however, persistent rainfall continues to disrupt harvest of the cotton crop, with some farmers about two weeks behind schedule. In general, though, there appears to have been only a slight effect on quality. A contact in the cotton industry reports that, with a vibrant U.S. economy, domestic mill consumption is the strongest in several years. Moreover, foreign demand is reported to be very strong. However, there is heightened concern in the industry that the Asian currency crisis will take a significant bite out of U.S. cotton exports this marketing year.

Rail disruptions in the Eighth District, stemming from the Union Pacific-Southern Pacific merger, continue to be confined primarily to Arkansas, where the bulk of UP's rail lines in the District are located. Accordingly, a contact in the grain supply and delivery industry in St. Louis notes minimal disruptions in Illinois, Indiana and Missouri.

NINTH DISTRICT--MINNEAPOLIS

As 1997 draws to a close, the Ninth District economy continues to enjoy robust, broad-based economic growth. Retail sales are strong, many manufacturers report full order books, and gas and oil development is at a high for the decade. While construction has cooled from the spirited pace seen earlier in the year, building activity remains at a high level. Crop yields and harvesting weather were generally favorable to farmers, and the financial condition of previously hard pressed ranchers continues to improve. There are few indications of price increases at any level.

On the negative side, tourism firms continue to report somewhat disappointing business. Wage pressures are reported in virtually all sectors and in most geographic areas. Finding qualified workers is a near-universal problem for employers.

Manufacturing and business services

“This is turning out to be our best year, better than we expected, and next year looks even better,” says a North Dakota furniture manufacturer. “Business is very strong,” reports a Minnesota-based vehicle and heavy equipment component manufacturer. Reports such as these are echoed across the manufacturing sector. Computer consulting firms, particularly those which design, install or train for computer networks, or review software for year 2000 problems, are reportedly swamped with orders.

Construction and real estate

Construction of all types continues very strong in most areas of the district. In Minnesota, residential building permit numbers were especially strong in September, but in October were about 2 percent below record levels of a year earlier. Western Wisconsin and southeastern South Dakota also report strong home building. Commercial and heavy construction is not posting the sort of year-over-year increases seen in spring and summer, but contractors continue to have plenty of work. There are two large office towers under way in Minneapolis. Commercial building also reportedly is strong in several towns in eastern Montana. Builders were favored with fall weather that allowed many projects to “get out of the hole” by completing foundation work before the ground freezes.

Natural resource industries

With 32 rigs drilling in North Dakota and Montana, gas and oil development is at its hottest pace this decade. With new wells in production, North Dakota oil production is 7 percent above year earlier levels. Iron ore output is largely stable, but low gold prices have led a Montana mine to delay a permitted expansion. Little change is apparent in forest product industries, with output reportedly unchanged from earlier in the year.

Agriculture

“We had an ideal fall,” reports a central Minnesota farm banker. “Everyone got their crops out and corn drying bills are lower than expected.” Similarly favorable harvesting weather prevailed across most of the district and contributed to a general mood of optimism in the farm sector. But the price picture is mixed, and corn/soybean producers reportedly are doing better financially than wheat or barley producers, while cattle and hog raisers are doing better than dairy farmers.

After more than two years in the doldrums because of low cattle prices, farm income, spending and loan repayment rates have climbed to near normal levels in the western Dakotas and in Montana. One negative note, severe plant disease problems combined with low prices have been a blow to small grain producers in eastern North Dakota, where bankers say incomes and spending are down notably. While cattle production continues above year-ago levels, veterinarians in parts of the Dakotas touched by severe cold last winter report unusually high rates of beef cows that did not conceive this season, a lingering reaction to stress suffered earlier in the year.

Despite high loan-to-deposit ratios, most banks that responded to the Minneapolis Fed third quarter survey of agricultural credit conditions had adequate supplies of loanable funds. Interest rates on most types of loans fell 20 to 50 basis points, to their lowest levels in two years.

Consumer spending and tourism

A Minnesota-based national retailer reported very strong sales for the third quarter of 1997, and regional hardware and department store chains echo with accounts of good business across most lines of general merchandise. Furthermore, industry sources generally agree

on optimistic expectations for holiday season sales. However, many continue to express concern about the continuing expansion of retail space in major regional markets and resulting stiff competition and tight margins.

Auto sales show moderate strength, according to registration numbers and reports from dealers association spokespersons. A businessman from northeastern Montana noted that improved cattle prices are resulting in strong demand for pickups, as ranchers make long-deferred replacements of their vehicles. As in general merchandise, structural change in auto retailing is accentuating competitive pressures for smaller independent dealers, particularly those in small towns. But sources in the sector are generally optimistic in their outlook for 1998.

Tourism is the weakest component of consumer spending. Reports are mixed, with some resorts in Minnesota and Wisconsin reporting moderate to good fall business. But visits to major tourist destinations in the Dakotas and Montana were disappointing overall. Good weather and ample game in key hunting areas is one bright spot.

Employment, wages and prices

Securing needed employees in a tight labor market remains a knotty problem for virtually all employers. A major manufacturer of personal computers located in South Dakota feels that further expansion in that state is stymied by a lack of workers. Many employers reportedly are giving wage increases, in the 3 percent to 6 percent range. But there are several reports of firms that have given boosts of 10 percent to even 20 percent to keep skilled manufacturing technicians or computer specialists. Moreover, a chain of airport shops hiked starting wages from \$6 to \$8 per hour to maintain needed staff.

Reports of product price increases are less common than those of decreases. Propane for heating and crop drying is in better supply than last year, and dealers expect lower prices. Some manufacturers report price drops for general and some specialty grades of steel. Those who manufacture components for other firms also report continuing pressure to lower their prices and are doing so through increased productivity.

TENTH DISTRICT - KANSAS CITY

Overview. The district economy continued to grow moderately the past month, while showing a few signs of easing. Manufacturing activity remained fairly strong and retail sales edged up. Construction activity was generally unchanged, while energy activity declined slightly. In the farm economy, good results have been reported for the completed fall harvest, the winter wheat crop appears to be in good conditions, and ranchers face favorable feeder cattle prices. Labor markets remained tight in much of the district, with limited evidence of wage pressures. Prices generally held steady at the retail level, while increasing slightly for some construction and manufacturing materials.

Retail Sales. Retailers report sales increased last month and were slightly higher than a year ago. Retailers are optimistic that sales will increase over the holiday season. Most retailers were satisfied with current stocks but expect inventories to decline slightly according to seasonal patterns. Automobile dealers report sales were generally unchanged last month and slightly lower than a year ago. Sales of light trucks and sport utility vehicles remained strong. Dealers have been expanding inventories slightly as they expect sales to improve somewhat in the coming months.

Manufacturing. Manufacturers continued to operate at moderately high levels of capacity last month. Manufacturing materials were generally available, with lead times holding steady for most items and increasing somewhat for a few others. Inventories edged down last month and no major changes are expected in coming months. A quarterly survey of district manufacturers indicated that production, shipments, and new orders all increased at a healthy rate from September to October.

Housing. Builders report housing starts generally held steady last month and were unchanged from a year ago. Builders anticipate a normal seasonal slowdown in construction activity in the coming months. Sales of new homes edged down. Most building materials were readily available and delivery times were normal. Mortgage lenders report slightly higher demand last month but expect demand to slacken in coming months.

Banking. Bankers report that loans increased and deposits remained unchanged last month, raising loan-deposit ratios slightly. Consumer loans, home equity loans, home mortgages, and residential construction loans all increased, while other loan categories were little changed. Increases in demand deposits, money market deposit accounts, and large CDs were offset by a decline in small time deposits.

Almost all respondent banks left their prime lending rates unchanged last month and expect to hold rates steady in the near term. Most banks did not change their consumer lending rates and anticipate no future changes. Some banks tightened their lending standards, citing concerns over credit quality or the economic outlook.

Energy. District energy activity declined slightly for the second consecutive month but remained somewhat stronger than a year ago. Crude oil and natural gas prices increased last month, but both prices remained below the peaks reached at the end of last year. The district rig count fell 6 percent in October to a level 8 percent higher than a year ago.

Agriculture. The fall harvest was completed with average to slightly above average yields for corn and soybeans reported in most areas. The district's winter wheat crop appears to be in good condition and was not affected by the recent snowstorm. Likewise, winter wheat pasture is expected to be plentiful and of good quality this season. Feeder cattle prices remain

strong and ranchers are earning healthy profits. Prices for fed cattle have edged up recently and feeders are making modest profits. Hog production in the district is profitable, and has been expanding significantly. Although hog prices have dropped seasonally in recent weeks, strong exports have kept prices at profitable levels.

Main street businesses in the district are benefiting from the health of the farm economy. District bankers indicate that the rural businesses are experiencing slightly higher profits than a year ago.

Wages and Prices. Labor markets remained tight last month in much of the district, with some limited evidence of wage pressures. Retailers report short supplies of entry-level and clerical workers, and manufacturers say skilled workers, such as engineers, were hard to find. A few companies say they raised wages more than normal to attract or retain workers, but many say wage increases were about normal. Prices held steady at the retail level but increased slightly for some manufacturing and construction materials. Retailers expect no major price changes in coming months.

ELEVENTH DISTRICT--DALLAS

Eleventh District economic activity expanded at a slightly slower rate in late October and early November. Although respondents remained optimistic about the coming months, some voiced concerns about future Asian demand. Those surveyed reported more wage increases and continued difficulties in hiring. A few manufacturing sectors reported slower growth. Business services and construction expanded, while loan demand remained stable. Recent rainfall improved agricultural conditions, but more rain is needed.

Prices. More respondents reported wage increases than in the last survey, with greater use of incentive bonuses. Salary increases at some real estate firms were more than 15 percent during 1997, and respondents expect about another 5 percent next year. One contact reported paying secretaries \$5,000 in monthly incentive bonuses.

Passenger fares, business and telecommunication service fees, and prices for paper and packaging all increased. Construction costs were up slightly, due to increases in wages and prices for brick, fabricated steel and some lumber products. Prices for scrap metal, freight service and cement remained unchanged. Contacts reported downward price pressure in the apparel industry due to international competition. Prices softened for some petrochemical products, and more declines are expected. Unseasonably cold weather, delays in coal shipments by rail, and natural gas production problems in the Gulf of Mexico pushed natural gas prices upward sharply. Increased demand for heating oil had little effect on its price because inventories were high. Crude oil prices were somewhat volatile during the tensions with Iraq. Memory chip manufacturers reported that increased industry capacity and customer inventory reductions combined to depress prices.

Manufacturing. Sales slowed in electronics and apparel, while demand continued to grow at the same rate in most other sectors. Sales of semiconductors and other electronic components grew more slowly as uncertainty about international demand, particularly in Asia, caused customers

to trim inventories. Shipments of apparel products are flat to down. Refining margins and capacity utilization continued to fall due to a seasonal decline, which was exacerbated by higher than normal heating oil inventories. Telecommunications manufacturers reported continued slow growth of sales and cautious optimism for the coming months, particularly for U.S., European and Latin American markets. They revised downward expectations for growth in Asian markets. Sales of paper products were down seasonally, but above year-earlier levels. Production of petrochemical products remained strong, but contacts expressed concerns that weakening Asian demand would stimulate exports to the United States. Sales of commercial construction-related products increased over the past six weeks, but demand for residential construction-related products softened seasonally. Both remain above year-earlier levels. Strong demand for commercial construction products caused steel mills to ration wide-flanged steel beams.

Services. Demand for temporary staffing, accounting, consulting and legal services continued to increase, and respondents were optimistic about 1998, but they also reported being unable meet increasing demand because labor market tightness constrained their hiring. Legal and accounting services were stimulated by growth in initial public offerings, mergers, and acquisitions. Although the use of transportation services slowed seasonally over the past six weeks, contacts reported stronger market conditions than a year earlier, particularly for passenger travel and hi-tech freight. Shippers reported no significant improvement in rail bottlenecks.

Retail Sales. Retailers reported good sales growth throughout most of the district, with booming sales growth in Houston. Contacts expect a good holiday season. The strong dollar has lowered import prices and softened upward pressure on selling prices. Prices for some imported goods are expected to continue to fall in coming months.

Financial Services. Bankers reported steady loan demand over the past six weeks, with strong competition continuing in commercial lending. Credit unions reported a slowing in auto

loans, but expect them to pick up in the first quarter. Loan rates are stable, with the exception of slight declines in auto and mortgage rates. Credit unions reported that credit quality remains high.

Construction and Real Estate. Construction activity increased in the past six weeks, driven by increases in office and residential construction. Residential and commercial real estate activity was also very strong. Office rents increased, although at a slightly slower pace and vacancy rates declined further with continued strong absorption. Existing home prices have risen as construction and land costs have pushed up new home prices. Nonetheless, average and median prices for new homes have fallen slightly as the result of increased sales of lower priced "starter" homes. Contacts reported that in general, new home prices have increased over the past year only by as much as the five percent increase in construction costs. Inventories of new homes are slightly low.

Energy. Activity in oil services and machinery remains unchanged at extremely high levels. Strong demand cannot be met by existing capacity in the oil field services industry, and work is being rationed to customers as backlogs continue to build. Shortages of pipe, casing, and basic equipment were widely cited. Although there is still a general reluctance to expand capacity throughout the industry, shortages of skilled workers--such as engineers, welders, machinists and electronic technicians--pose difficulties for those who try.

Agriculture. Producers have nearly completed the cotton harvest and reports suggest that the crop is good. Recent rainfall was beneficial to winter pastures and small grains, but contacts indicated more rain is needed, as many wheat fields and pastures are reported to be in poor shape. Feeding of livestock increased in most areas, but winter pastures have responded favorably to cooler, wet conditions. The livestock sector remained in mostly fair to good condition

TWELFTH DISTRICT--SAN FRANCISCO

Summary

Reports from Twelfth District Beige Book contacts indicate solid growth along with a high level of economic activity in recent weeks. Retailers reported moderate gains in recent months, and service providers in the District noted an acceleration in growth from an already rapid trend. Manufacturing activity remained strong in much of the District, with many high-technology equipment manufacturers and Boeing operating at or near capacity. Steady demand for commercial real estate kept construction activity strong in most of the District, despite a slowdown in many housing markets. Respondents from financial institutions reported ample supplies of bank capital and liquidity, creating excellent terms for quality borrowers. Despite the healthy level of economic activity in recent weeks, respondents noted that labor shortages, shipping bottlenecks, and the strong dollar were beginning to dampen the District's rapid pace of growth.

Business Sentiment

Twelfth District respondents expect continued strong performance in the U.S. economy, with District growth outpacing the national rate. Slightly more than one-half of the respondents expect U.S. GDP growth to be at or near its long-run average pace, leaving the national unemployment rate at its present level. An increasing number of respondents anticipate a slight increase in prices in coming quarters, although a majority expect inflation to remain constant over the next 12 months. With regard to regional conditions, nearly all respondents expect growth in their area to outpace national growth in the coming year, with District business investment and consumer spending expected to post relatively fast growth.

Retail Trade and Services

Retailers in most District states reported moderate growth in retail sales. In California and the Pacific Northwest, contacts reported solid sales in recent months, boosted by strong demand for apparel and home furnishings. In contrast, retail contacts in Utah noted slower department store sales and reduced demand for “big-ticket” items, such as cars and trucks. Nearly all District retailers reported difficulty finding entry-level workers and many reported offering increased wages and larger employee discounts to attract temporary holiday help.

Service industry respondents continued to report strong growth. Respondents from Northern California and the Pacific Northwest reported healthy demand for telecommunication and business services. Demand for shipping and freight services continued to increase in many District states. In Southern California port traffic growth reportedly accelerated over an already rapid trend. Throughout the District, service industry respondents reported a dearth of employees at the desired skill levels. Contacts also noted that high turnover rates and short employee tenure were becoming primary concerns. However, many respondents remained reluctant to raise overall wage levels and instead have begun to take other actions, such as converting part-time to full-time jobs and giving periodic merit awards.

Manufacturing

Reports on District manufacturing activity were generally positive, although the strong dollar, shipping bottlenecks, and labor shortages have tempered growth in some areas and industries. High-technology equipment manufacturers reported healthy growth and firms involved in commercial airplane manufacturing reportedly are running at full capacity. In the Pacific Northwest, the wood product industry continued to benefit from improved orders for pulp and paper

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products. Growth in the unprocessed lumber and food processing industries weakened in recent weeks, but remained at healthy levels. Respondents cited the strength of the dollar relative to East Asian currencies as the primary reason for this slowdown. Shipping bottlenecks and labor shortages, particularly for skilled workers, continued to constrain activity in many industries and areas. Manufacturing contacts in the Pacific Northwest, where shipping bottlenecks have been particularly troublesome, reported shifting to higher cost providers of freight services in order to meet scheduled production goals. To fill employment vacancies, respondents in the manufacturing sector reportedly have resorted to hiring unskilled labor to fill skill positions.

Agriculture and Resource-related Industries

Agricultural conditions generally were favorable throughout the District. Contacts reported healthy conditions for most crops and livestock. However, recent railroad capacity constraints reportedly resulted in handling and storage difficulties for producers of perishable crops, particularly grain. In addition, the depreciation of East Asian currencies reportedly softened demand for many raw agricultural products, as the relative price of U.S. crops increased significantly.

Real Estate and Construction

Commercial real estate activity continued to increase in most areas of the District, keeping District construction activity at high levels despite a slowdown in many housing markets. Respondents in many areas of the District noted slowing sales of both new and existing homes. Contacts in the Pacific Northwest and Utah noted that high material, land, and labor costs have made it difficult for developers to build housing that buyers can afford. However, commercial real estate and construction activity in these areas remains strong and has kept demand for contractors, subcontractors, and materials well beyond the available supply.

Financial Institutions

Twelfth District banking conditions continued to be strong. Respondents reported that bank capital and liquidity were in ample supply and competition for loans remained fierce, with quality borrowers receiving excellent terms and rates. On the other hand, some respondents noted that overall consumer credit quality has deteriorated as borrowers continue to overextend themselves through excess credit card usage. Despite ongoing bank consolidation, the pool of available labor for the financial industry continued to tighten. In some areas of the District, labor shortages have induced banks to convert part-time positions to full-time jobs in an effort to attract employees.