SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICTS

OCTOBER 1986

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SUMMARY*

District Reserve Banks report overall economic growth ranging from relatively stable to slightly improved, with conditions varying considerably by region and economic sector. Strength in consumer spending is somewhat less evident than in last month's reports. While residential construction activity remains relatively strong, reports of some weakening come from several regions. Manufacturing activity continues to be weak, with some specific exceptions. Prices, both at retail and for materials inputs, are generally reported to be steady. The serious slump in the energy industry continues, though some hints of modest improvement are reported. The depressed farm economy has been put under additional stress in some areas by drought and by heavy rains and floods. Loan activity at commercial banks is reported to be generally weak, with business lending relatively weak and real estate and consumer lending relatively strong.

Consumer Spending

The general strength in retail sales reported in the last Beige Book is less evident in this month's reports. Improved retail sales, with gains in some instances greater than expected, were reported in half of the districts. The remaining six districts reported some recent weakening in sales (Boston, Cleveland, Atlanta, Chicago), continued slow sales (Dallas), or sales growth slower than expected (Philadelphia). Where specific goods lines were mentioned, hard goods (especially appliances and home furnishings) were generally selling better than soft goods, though apparel sales were strong in several districts. Retailers in the Boston, New York, Chicago, and Richmond

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districts are optimistic about sales through the rest of the year, including the Christmas season. Concern about Christmas season sales is expressed in the Philadelphia, Cleveland, and Dallas districts. Inventory levels are generally viewed as ranging from slightly low to satisfactory. Retail prices are described as steady to "remarkably stable."

Domestic new car sales responded strongly in all districts to national incentives, and 1986 model inventories have been generally worked off. Concern is expressed in some districts about an expected sharp decline in auto sales and about the effect of large monthly car payments on discretionary income and other consumer purchases.

Foreign and domestic tourists have bolstered consumer spending in the New York area. Tourism was up modestly in the Richmond district, but not as much as expected. In the Atlanta district, tourism remains strong but construction of many new lodging facilities has held down the benefits to individual hotels. Tourist traffic has been strong in the Pacific Northwest but disappointing in southern California.

Construction and Real Estate

Residential construction activity remains relatively strong, but reports of weakening come from several areas. The pace of homebuilding activity is reported to be vigorous by New York and Atlanta; New York reports no let-up in sight but Atlanta expects some slowing soon. Housing activity in the Boston district remains strong, but is moving back towards normal after the fast pace of recent years. Residential construction is likely to continue at a high level in Chicago into 1987. Minneapolis reports strength in housing in Upper Michigan and North Dakota as well as in Minnesota. Residential construction activity is reported to be generally good in the San Francisco district, except in Idaho and Alaska. Both Cleveland and Richmond see a slowdown in housing activity, while both Kansas City and Dallas report a recent slippage in residential construction.

Nonresidential real estate activity is reported as mixed. Commercial vacancy rates are rising in New England's urban centers but suburban shopping mall space is still in demand. Contacts in New York report some pick-up in commercial and industrial leasing. Commercial construction is weaker in the Richmond district, and Atlanta reports sizable concessions on office leasing. The vigorous pace of office and retail building in Chicago is expected to continue into 1987. Moderate expansion in nonresidential construction activity in the St. Louis district has been spurred by vigorous growth in Arkansas, Kentucky, and Missouri.

Manufacturing

Manufacturing activity continues to be generally weak, but with some exceptions--such as defense-dependent businesses in New England, and aerospace and related electronics businesses in the San Francisco district. This generalization holds even though contacts report modest improvement in some areas and some industries, such as furniture and textiles and apparel in the Richmond and Atlanta districts. Capital spending continues to be weak, with productivity enhancement a much more important factor than expansion. Manufacturing employment continues to contract, and prices of materials inputs are generally reported to be steady. The USX strike benefited other steel producers in both the Cleveland and the Chicago districts. Steel demand is reported good for autos, appliances, and construction uses; weak for equipment, railroads and shipbuilding. Automobile output has been falling persistently short of plans in recent months, and fourth quarter output plans have been reduced from earlier projections. Although light truck sales are setting records, medium and heavy truck sales have been steady to down.

Energy and Resources

The serious slump in the energy industry continues despite somewhat firmer prices. Some slight stirrings are reported, however. While leading indicators of gas and oil drilling activity are still mixed, Atlanta, Dallas, and Kansas City report a very slight upturn in the drilling rig count. Chicago notes that while orders for steel for use in the oil and gas sector remain very low, they are up from zero earlier this year. Minneapolis reports a little activity in the oil and gas fields of North Dakota. Some improvement in the timber and forest products industry is reported by Atlanta, Minneapolis, and San Francisco.

Agriculture

The farm economy remains depressed, and additional stress has been put on parts of the industry by drought and by heavy rains and floods. Grain crops, hay, and tobacco suffered from drought in the southeastern states, reducing cash receipts. Heavy rains and flooding in parts of the Chicago, St. Louis, and Kansas City districts delayed fall crop harvests, reduced yields, and also delayed winter wheat planting. But overall reductions from projected record yields of corn and soybeans are believed to be only modest. Government payments are expected to be a substantial support to grain, cotton, and rice farmers. San Francisco notes increased cotton exports, along with good fruit, potato, and bean crops in the northern states of its district. Livestock producers generally face a positive income outlook, due to strong meat prices and low feed costs.

Banking and Finance

Total loan activity appears to be generally weak, with business lending typically reported as relatively weak and both real estate and consumer lending relatively strong. One exception is Philadelphia, which notes that demand for commercial and industrial loans remains strong. Philadelphia also says that banks are implementing more stringent credit qualifications for business borrowers. Atlanta notes a "more cautious lending atmosphere" for consumer loans, and St. Louis states that most district banks and thrift institutions have tightened lending policies for nonresidential real estate loans.

Small and medium-sized banks in the New York district are coming under competitive pressure to lower lending rates. They are also lowering rates paid on variable rate accounts, and reluctantly beginning to look at "fixed rate" accounts. Some banks in the Richmond district have lowered passbook rates, but with a wary eye on the competition.

FIRST DISTRICT - BOSTON

With the exception of defense-oriented firms, First District manufacturing continues to be sluggish. Foreign sales are picking up for most exporters. Retailers in the region generally saw improvement in September but results were mixed in early October. Prices are stable or declining for manufacturers and rising moderately if at all for retailers. New England's labor markets remain tight.

Retail

Retail contacts reported sales in September well ahead of last year on a comparable stores basis. The first week in October continued this strength in some stores, but showed weakening in others, especially in stores carrying general merchandise. Hard goods are selling better than soft; one contact reported this had an adverse effect on profits because their margin is higher on soft goods. Inventory levels are varied but were said to pose no serious problems.

Prices remain "remarkably stable." Vendor price increases are selective rather than across-the-board, and those occurring recently were in a moderate range of 1 to 3 percent. While prices of some imported goods have risen, contacts said the increases to date have been modest. Competitive pressures keep retail prices in line with vendor prices.

Unemployment remains low in the region. Some merchants have increased starting wages in order to recruit employees, but several expressed the opinion that the problem is not one of wage levels but simply a shortage of bodies to fill "low-skill" openings. Concern is growing about whether enough temporaries will be available to support holiday season sales. But low unemployment has a positive side as well; New England retailers are optimistic about sales in the remainder of the year, citing the region's low jobless rate and high incomes. Those with branches or affiliates elsewhere report that their northeastern divisions continue to outperform others.

Manufacturing

The District's manufacturers continue to struggle for any gains except in defense-dependent businesses. Government demand for machinery and fabricated metals is fairly good, sometimes better than expected. However, sales of machinery and tools to the auto, commercial aircraft, and oil industries are weak or deteriorating. Sales of chemicals and plastics are flat. Instrument sales are mixed with medical instruments showing most strength. Computer makers indicate that sales will rise only modestly this year with office automation performing best. Almost all respondents report an increase in foreign sales, especially to Europe. For several, exports represent the sole bright spot.

While some firms alluded to tight labor markets, most are holding employment constant or are letting it fall through attrition. A few layoffs have occurred or are contemplated. Respondents foresee wage increases of 3 to 6 percent in 1986. Capital spending also remains minimal and is focused on maintenance, consolidation, or restructuring - not expansion.

Keen competition and oil price declines have combined to keep prices stable or falling. Most firms are emphasizing cost containment, and one reports sharing technology with suppliers to reduce costs. Input prices, including imports, generally remain level as well; exceptions include nickel (because of depleted stockpiles) and semiconductors (because of the recent anti-dumping pact). Although most firms expect few price increases, one suggested that possible cost reductions are almost exhausted.

Only the tool makers have seen a recent pickup in orders. Others, including defense contractors, foresee no major changes. A few respondents cite tax reform as a current concern.

Real Estate

Reports of residential real estate activity in New England vary widely, with some indication that conditions are moving toward normal after the fast pace of the last few years. While some agencies, particularly those close to Boston, claim that home sales are down, others say that business is strong. Where activity is booming, buyers exceed listings and prices are still climbing. Agencies facing slower activity, however, report that high prices are reducing the number of buyers and causing them to take more time in making purchasing decisions. Condominiums continue to do well.

Vacancy rates for commercial real estate in New England's urban centers have risen as new construction has recently come on line in these locations. Retail space in suburban shopping malls, however, appears to be in demand.

SECOND DISTRICT--NEW YORK

The Second District's economy showed some modest improvement in recent weeks. Retailers had sales gains that were generally higher than expected and residential construction continued strong. Business activity was stable to improved, while some seasonal pickup in the demand for office space occurred. As the general level of interest rates has declined, small District banks report increased pressure to reduce their lending rates.

Consumer Spending

Consumer spending was stronger than expected at a number of District stores during August and September, and retailers reported sales gains well above target. Sales were bolstered by domestic tourists who continued visiting the District to view the refurbished Statue of Liberty, and by foreign buyers responding to the dollar's decline. As a result of strong sales, inventories are currently at or below desired levels in much of the region.

During August, over-the-year sales growth in the District ranged from 10-20%, while September gains were in a 10-15% range. One retail chain attributed a better-than-average showing among its stores in the District to more favorable local weather and fewer major economic problems such as those currently affecting the farm and oil regions. Among those items generally cited as in strong demand recently were home furnishings, men's and women's apparel, and various kinds of accessories.

With regard to the outlook, a recent survey (conducted by a national accounting firm) of some 250 upstate retailers indicated widespread optimism concerning sales gains and control over inventories in the fall and holiday seasons.

Business Activity

The improved tone in the Second District's economy continued during recent weeks though few additional gains have been noted. Purchasing managers in the Rochester area, for example, report that their economy remains strong with 88 percent of them characterizing general business conditions as stable or improved in September. And in the Albany area, while some businessmen described the local economy as plateaued, others pointed to a pickup in business conditions during the third quarter.

Overall employment has expanded further in the District, though the manufacturing sector continues to contract. The September unemployment rates in New York and New Jersey were 6.1 percent and 4.7 percent, respectively, well below the national average. In addition, the over-the-year declines in the New York and New Jersey unemployment rates of half a percentage point surpassed the 0.1 percentage point national decline. Concerning the future, with Congress currently debating whether or not to fund further production of jet trainer planes at Fairchild Republic, considerable apprehension exists among the 3500 Long Island employees whose jobs at that plant are at stake.

Construction and Real Estate

The pace of activity among District homebuilders is still vigorous with apparently no letup in sight. Builders are encountering no shortage of buyers, though in some areas they continue to have difficulty in completing construction on time. Skilled labor remains in short supply in these areas and the problem may worsen since many summer workers have returned to college. Home prices continue rising and, reportedly as a result, for the first time in several years some upstate builders are engaged in speculative construction. Since demand remains strong, these builders prefer to sell after completion in anticipation of securing a higher price than could be obtained by signing a contract in advance.

Some seasonal pickup in commercial and industrial leasing activity has occurred in recent weeks, but conditions in the Second District have otherwise shown little change. Leasing activity in downtown Manhattan reportedly is somewhat stronger than in midtown as demand for space in new financial district buildings remains strong. A more than ample supply of office space remains in northern New Jersey and Fairfield and Westchester counties. However, Westchester has recently been experencing a flurry of leasing activity as several large firms from outside the county have taken space.

Financial Developments

Small and mid-size banks in the Second District report increasing pressure to lower their lending rates as other interest rates have declined. In part, the pressure exists because many bank loans, such as corporate loans, commercial mortgages, and some consumer loans, are directly linked to the prime rate. In addition, competition has been particularly strong for home equity and automobile loans. Despite a lowering of their home and auto loan rates, however, several banks have found their share of these markets considerably reduced. Moreover, as rates on business and consumer loans declined, so did the spread between interest earned and that paid on deposit accounts. As a result, surveyed banks have been lowering the rates they pay on variable rate accounts--CDs, NOWs and money market accounts. Most expect a further narrowing of the interest rate spread as their higher earning securities and mortgages mature. Consequently, some banks are considering lowering rates on "fixed rate" accounts, such as passbook savings, despite widespread reluctance to pursue this option.

THIRD DISTRICT - PHILADELPHIA

The Third District economy continues to expand at about the same overall pace as it has since mid-summer. Activity in the manufacturing sector rose marginally in October for the fourth month in a row. Retail sales are also growing, although not quite making the increase merchants had been expecting. Total loan volume at major Third District banks is growing at slightly above the pace set during the first three quarters of the year, with commercial lending and real estate financing posting the strongest gains. Consumer lending, while still growing at a fair rate, has not accelerated.

Expectations for the Third District economy are generally positive, although optimism has waned somewhat in recent weeks. On balance, manufacturers expect improving business over the next six months or more. Retailers are sticking with earlier predictions of a good fourth quarter, although some now believe that the upper range of their forecasts may not be attainable. Bankers expect continued strength in commercial loan demand, but they see consumer credit demand slackening next year.

MANUFACTURING

The pickup in manufacturing activity that began in the region this summer has entered its fourth month, according to the latest Business Outlook Survey. Industrial firms posting gains in October slightly outnumbered those reporting slowdowns for the month. Business is expanding for 24 percent of the survey respondents, dropping for 14 percent, and holding level for 54 percent. Improvement is more marked in the nondurable goods sector than in durable goods.

Most indicators of manufacturing activity show improvement this month. New orders, shipments, and order backlogs are up, and inventories are falling slightly. Employment remains at a standstill, however. Responses to the October survey reveal mostly steady payrolls in the region and a fractional drop in working hours.

Some upward pressure on industrial prices in the region is evident in this month's survey. Although the majority of survey respondents say input costs are steady, more now report increasing charges than at any time this year. Area companies' selling prices are largely unchanged, however.

Local manufacturers generally have positive views of the future. On balance, survey respondents foresee continued expansion through at least the first quarter of next year. They predict a growing rate of orders and shipments, but they do not expect any gains in employment. Industrial firms' capital spending plans call for slightly greater outlays, overall, during the next six months.

RETAIL

Department and general merchandise stores in the area report year-over-year sales increases of up to 10 percent in mid-October. However, some say this is below expectations. Unseasonably warm weather in late September and early October has restrained sales of fall outerwear, according to store officials. As these lines account for a substantial portion of sales at this time of year, continued poor performance could hold down results for the quarter.

Discount stores generally have been experiencing slower growth than stores with more up-scale merchandise. Two large discount chains have entered the area in recent months and a third is planning a major expansion of its presence in the region, restricting growth of sales per store. Greater price competition has also narrowed selling margins.

The apparent slowdown in retail sales is beginning to prompt concern for the Christmas season among merchants. However, they are still hoping to meet their sales objectives for the holidays. Store officicals say there is little they can do at this late date to alter plans, anyway.

FINANCE

Total lending by major Third District banks grew approximately 5 percent from August to September. Total loan volume outstanding in September was approximately 17 percent above the year-earlier period. Demand for commercial and industrial loans remains strong. Some banks are implementing more stringent credit qualifications in this category, however, which they expect will slow the growth of their lending to this sector. Prospects of a softer economy during 1987 are motivating this caution, according to these banks.

Real estate lending also remains strong. Banks active in construction financing say they are lending to financially sound contractors for both commercial and residential development. Almost no speculative building is being done, and bank-financed projects are usually substantially pre-leased or have long-term commitments from mortgage lenders.

Consumer installment lending is generally experiencing healthy growth, but the rate at which credit card outstandings is increasing has slackened. Bankers speculate that consumers have held back in taking on more of this type of debt while they have increased purchases of automobiles. Some bankers predict even slower growth in consumer lending during the fourth quarter as automobile loan payments begin for cars bought during the latest round of manufacturers' incentive financing programs.

Total deposits at large Third District banks grew approximately 12 percent from August to September. For the month, deposits were also 12 percent above September 1985. Some banks report a slowdown in the growth of savings deposits and certificates of deposit. Although some of this is a result of liability management strategies, weakening growth in core passbook and statement savings deposits is becoming a matter of concern at some institutions.

FOURTH DISTRICT - CLEVELAND

Summary

The regional economy during September has remained relatively stable. The outlook for the region is less optimistic than previously reported with the majority of respondents to a recent survey predicting no change. Economic indicators are generally mixed: Retail sales and housing have declined slightly; orders and inventories are mixed; and capital, borrowing and employment plans are down. Despite overall regional economic doldrums, some metropolitan areas, such as Columbus and Cincinnati, are experiencing healthy expansions.

Retail

Retail sales during September were slightly lower than reported for the previous month. In addition, the composition of sales has changed; retailers report that sales of hard goods considerably outpaced soft goods sales. Retailers attributed this change to the increase in housing sales earlier in the year. Looking toward the holiday season, the Christmas sales outlook is more pessimistic than any reported in the last three years, especially for the Northeast portion of the district.

Domestic auto dealers in the Fourth District reported that sales have been driven primarily by the recent incentive programs. Most dealers reported a 20-25 percent increase over the same period in 1985. Sales surged immediately after the announcement of low interest rate financing, tapered off during September, and then jumped again right before the incentives expired.

Several dealers mentioned that the even lower 2.4 percent and 2.9 percent financing arrangements stirred the market again, after the previous round of incentives had lost their appeal. The incentive program apparently lowered dealers' inventories of 1986 models, below normal carry-over levels, and non-GMC dealers said that levels of 1987 models were very tight. Import dealers reported that the domestics' incentive programs helped to increase import sales by about 10 percent, even though they did not offer similar financing rates.

<u>Labor Market Conditions</u>

August unemployment in Ohio rose by 0.5 percentage points since July to 8.5 percent of the civilian workforce, compared to the national rate of 7.0 percent. The rate still remains below the 9.2 percent level of a year ago.

Total employment in Ohio rose by 0.2 percent from the previous month and by 3.1 percent for the year ending in August. Employment in the fifteen largest MSAs in the district rose 0.1 percent during August and 2.8 percent from a year ago. Employment changes were mixed in the largest metropolitan areas. Cincinnati and Columbus recorded greater than average growth (0.5 percent and 0.4 percent change since last month), while Pittsburgh lost jobs (0.6 percent) and Cleveland remained virtually unchanged.

In most cases, nonmanufacturing employment has risen at the expense of manufacturing employment. In Ohio, a 4.8 percent employment gain in nonmanufacturing since last year was more than enough to offset a 2.0 percent decline in manufacturing employment. The service industries were the strongest component of employment growth in Ohio. The 7.4 percent increase in the service sector brought it within 50,000 jobs of overtaking manufacturing employment. Wholesale and retail trade also increased employment substantially (by 5.2 percent); this sector now employs 9,000 more workers than does the manufacturing sector in Ohio.

Surveys of both manufacturing and nonmanufacturing companies reveal plans to hire slightly fewer workers in the near term.

Manufacturing

Once again, the region's manufacturing outlook is mixed. Employment was relatively steady over the past few months, but remains far below its level during the peak of the last business cycle peak. Orders in consumer durable and capital goods are up, but orders in materials and services and technology are down. At the same time, inventories of consumer durables are higher, while material and services and technology are lower. Companies have revised downward their plans for capital expenditures in the coming quarter and are also scaling back their borrowing plans. However, a high proportion of companies surveyed are planning to cut inventories in the coming months in anticipation of a decline in sales.

Steel industry employment in Ohio during August fell by 5 percent from the previous month. The decline was considerably worse in Pittsburgh (15 percent) whereas Cleveland's employment remained stable. However, reported production increases of 10 percent in the Pittsburgh area during September may cushion the sharp employment decline experienced in August.

Much of the difference in employment experience had to do with the location of USX steel facilities that have been shut down since August 1. In some parts of the district, the USX strike has been beneficial to workers employed by competing steel producers. For example, LTV, which is operating under Chapter 11 protection, is enjoying a considerable increase in orders.

Despite the overall decline in manufacturing employment and union wage concessions, weekly earnings among production and non-supervisory workers in manufacturing rose by 1.5 percent in Ohio for August, compared to a 0.5 percent increase for the U.S. Average hours worked rose by .6 hours, which is similar to the national change.

Housing

Housing activity in the Midwest shows clear signs of slowing down. However, the activity in most housing markets in the district remains higher than a year ago. Some areas, (in particular, Columbus, Dayton and Cincinnati) report considerably more building and sales than do other areas of the district. Conditional on mortgage rates, housing market participants forecast moderate housing activity in the Midwest through the rest of 1986 and into 1987. Housing activity in the District appears to be very sensitive to interest rates, since the region is not experiencing substantial inmigration or demographic changes. Those interviewed foresee a housing boom only if mortgage rates fall below 9 percent.

Lenders report shallow demand for the adjusting rate mortgage because most lenders refuse to discount these products enough to induce borrowers to accept them. This is consistent with the fact that most borrowers perceive the current level of mortgage rates as the trough in long term mortgage rates.

Banking

Overall loan demand has improved at district banks, primarily because of the strong demand for consumer installment credit and mortgage loans. Consumer installment loans increased at an annual rate of over 25 percent, and real estate loans rose 16 percent. Business loan demand, on the other hand, was sluggish, and commercial and industrial loans fell at an annual rate of nearly 7 percent over the last six weeks.

FIFTH DISTRICT - RICHMOND

Overview

Manufacturing and retail sales are stronger, and producers and retailers expect further improvement in the months ahead. Sales by service firms continue to grow. Residential and commercial construction are weaker, and lenders expect building activity to slow further. Loan demand is weak at depository institutions, but earnings are up. The drought-depressed agricultural harvest and low crop prices are putting additional stress on the region's farmers.

Consumer Spending

Forty-six percent of the retailers responding to our survey this month report increases in sales; last month, only 23 percent reported increases. On the other hand, 39 percent of this month's respondents report declines in sales, compared with 27 percent last month. Looking ahead six months, 69 percent of retailers expect increases in sales, and 10 percent expect declines. The corresponding percentages from last month's survey were 54 and 8.

Summer tourism in the District was up about 5 percent this year over last year. An even larger increase had been expected because of low gasoline prices and the decreased appeal of traveling abroad.

Manufacturing

Manufacturing activity is increasing, according to our survey of District firms. Fifty-seven percent of this month's respondents report increases in shipments, and 41 percent report increases in new orders. The corresponding percentages from the previous survey were 34 and 28. The survey results also indicate increases in manufacturing employment and the length of the workweek. Inventories of materials and finished goods declined slightly for the third consecutive month. Within manufacturing, increases in activity are most notable in nondurable goods industries, including textile and apparel firms. Durable goods industries such as furniture manufacturers, however, also report improved business conditions. In general, manufacturing firms expect activity to improve further in the months ahead.

Services

Service sector respondents report continued growth in activity. Forty-four percent report sales increases, while 20 percent report declines. The corresponding percentages from the previous survey were 41 and 24. Services respondents are less ebullient about the future than they were a few weeks ago; the percentage expecting sales increases over the next six months declined from 68 last month to 53 this month.

Longshoremen have signed new contracts in North and South Carolina, and are working under contract extensions in Maryland and Virginia. Unions working without new contracts refused to accept the two-tier wage scale, which pays lower rates for certain kinds of cargo, that was agreed to by locals at other ports.

Financial

Bank and savings and loan executives report high earnings and plentiful supplies of loanable funds. Banks in some cities are competing aggressively for home equity lines of credit as well as new car loans now that most manufacturers' promotions are over. Loan demand for residential and office building construction and mortgage loan demand are weakening and are expected to decline further. Some depository institutions have lowered their passbook rates. Others would do so, they say, if it were not for their fear of losing deposits to competitors.

Agriculture

The District fall harvest is in full swing and the impact of the summer's prolonged drought is being felt. Yields of the field crops--corn, soybeans, and some small grains--have been hurt the most, but hay and tobacco yields are also down significantly. Low yields and downward pressure on crop prices are expected to result in a 20 to 30 percent decrease in crop cash receipts compared with last year. Livestock producers may fare better this fall as strong meat prices will combine with lower feed costs to widen their margins and offset the heat- and drought-related losses of the summer. The availability of agricultural credit remains generally good throughout the District, but bankers believe that the financial position of farmers will deteriorate further this year. The extent to which federal loans will ease the shortfall in agricultural income is not yet known.

SIXTH DISTRICT - ATLANTA

The Southeast's economy registered mixed performance as weaknesses in some sectors offset strengths in others. Petroleum still tops the list of several weak primary industries in the region. The farm economy remains depressed, and Alabama employment is suffering from coal mine closings. Some commodity exports may be on the rise, however. Vigorous construction and sales of single-family homes are promoting growth of domestic lumber, furniture, and other consumer durable goods production. Tourism too boosted the region's economy. Department store sales outpaced those in the nation, while District auto sales lagged the national rate.

Employment and Industry. Regional labor markets improved marginally from July to August; employment rose slightly, and the District unemployment rate fell by 0.2 percent to 8.1 percent. The trade and service sectors contributed most of the job growth, while manufacturing continued to edge below year-ago levels. Only Georgia and Tennessee, with unemployment rates of 6.0 and 7.9 percent, respectively, posted declines from a year ago. Mississippi's rate increased to 12.7 percent, the nation's highest.

Declining petroleum revenues have diminished tax revenues in Louisiana and Mississippi. In especially hard-hit Louisiana, the governor has imposed a 10 percent cutback in state expenditures at all levels. New Orleans faces severe revenue shortfalls as well. Total employment declined in August in Mississippi, Louisiana, and Florida. Bank directors report that large Florida computer manufacturers are cutting job rolls as a result of stiff competition and weakness in the computer market.

Demand by the housing industry is stimulating regional lumber production, although contacts in Mississippi report continued weakening in that state. The furniture industry has been expanding rapidly in Tennessee and Mississippi, and home appliance producers in the region have noted accelerating demand, both outcomes due to an increase in home building. Textile industry spokesmen note that their capital spending has gone mainly to productivity enhancement and not to expansion. Department of Defense spending on shipbuilding, uniforms, and electronics is boosting business activity in the region. Tennessee's aluminum shipments, however, have weakened.

Consumer Spending. Through July, southeastern year-to-date sales growth continued to outpace that of the nation. However, retailers reported poor sales of apparel and durable goods during September due to unseasonably hot weather. Low automobile finance rates diverted funds from purchases of other items such as appliances and furniture. Most District retailers are reporting favorable sales increases over year-earlier levels, but some Louisiana retailers are still plagued by double-digit sales declines. The sluggish sales pace is inducing retailers to maintain lean inventories.

Car buyers in the region responded to the special financing programs introduced by manufacturers in September. As a result, inventories of unsold 1986 models were virtually exhausted by the second week of the program. Still, the fall sales pace in the region was much below the comparable rate nationally.

Construction. Single-family residential building and sales maintained most of their strength through mid-October, though a second consecutive monthly decline in single-family building permits (seasonally adjusted, three-month moving average) suggests construction may slow soon. Aggressive construction has boosted builder inventories, although these are not yet viewed as troublesome in most markets. According to an Orlando source, apartment tenant turnover has accelerated because lower mortgage rates have narrowed the gap between rental and mortgage payments.

District commercial developers face increasingly strict preleasing requirements prior to construction loan approval. Additions to established complexes or new construction in developed areas qualify for lower preleasing requirements; "pioneering" projects are subject to higher standards. Though quoted office lease rates are holding steady, sizeable concessions are pandemic in District markets.

Financial Services. August loan growth at large commercial banks in the District declined two percentage points from year-earlier levels due primarily to slower consumer lending advances. Bankers blame the low auto finance rates offered by automobile manufacturers for much of the decline. Bank contacts in Nashville and Tampa add that high consumer debt levels and rising bankruptcy rates are creating a more cautious lending atmosphere. District bankers acknowledge they will have to create new consumer products to supplement those made less attractive by tax reform, such as IRAs and home equity loans.

Tourism. Tourism in the Southeast remains generally strong; increases have been noted for both automobile and air travel. Cruise ship bookings are also solid, industry sources report. Foreign travel to the United States seems to be rebounding. Miami hotel occupancy is up slightly due to increased travel from Brazil and Chile. Hotel occupancy has been off in many regional cities because of construction of many new lodging facilities. Louisiana has closed 20 out of 32 state-operated travel attractions and is laying off tourist-related employees.

Agriculture and Mining. At mid-year, southeastern banks held $70 million (2 percent) less in farm loans than at the same time last year. Declines of nearly 10 percent in Louisiana and Mississippi were partially offset by a 17 percent rise in Florida farm loans. The difference in lending behavior reflects the lesser financial distress of Florida's farm sector.

Regional farm cash receipts are trending 13 percent lower than in 1985, but farm income will be supplemented by heavy government payments to cotton and grain farmers.

Southeastern coal production for the first eight months of 1986 fell approximately 8 percent below the same period in 1985 as a result of Alabama mine closures. With modest oil price increases, the Louisiana petroleum industry is showing renewed signs of life. Since reaching a low of 92 operating rigs in early August, the state rig count has climbed to 120. Reports from primary industries indicate a recent improvement in export volume.

SEVENTH DISTRICT--CHICAGO

Summary. Our contacts believe prospects are favorable for further moderate growth in the national economy in 1987, and continued price restraint. Activity in the District, overall, still trails the U.S. However, this year housing construction here has outpaced the nation. Cutbacks in employment continue to be announced by various major employers in the region, many in service sectors which had avoided large layoffs in the past. Contacts report continued vigor in consumer purchases, construction, and defense. Inventories are low at auto dealers, general merchandisers, and many manufacturers. Sales of paperboard, cement, gypsum board, and other building products are at or near record levels. Exports of linerboard are up sharply, helped by the lower dollar. Planned auto output is at high levels into next year, but fourth quarter production has been cut from earlier announced levels. Capital goods sales are slow. The protracted strike at USX has boosted prices and volumes for other steel producers. Crop losses due to heavy rains and flooding in September and early October were extensive in parts of the District. Overall corn and soybean losses, however, probably will be only modest. The drop in District farmland values apparently steepened in the third quarter.

Steel. The strike which has shut down USX since August 1 is helping other District producers. There are no shortages. Inventories built ahead of the strike by USX and its customers helped prevent supply problems initially. Other U.S. companies have been reactivating idle facilities. With longer leadtimes for sheet and other light products, and fewer order cancellations, steel makers have scheduled longer, more efficient production runs. Steel demand is described as good for autos, appliances, construction, and steel service centers. Weakness continues to be reported in steel for equipment, railroads, and shipbuilding. Orders for use in the oil and gas sector also remain very low but are up from near zero earlier this year.

Motor Vehicles. Auto output plans are at a high level into 1987. However, actual production has fallen persistently short of plans in recent months. Fourth quarter planned output has been reduced from earlier projections, despite sharply lower inventories. Analysts think record low financing rates and rebates pulled sales into model year 1986, and expect lower sales next year. Sales of light trucks, many for consumer use, have been setting records. Medium truck sales this year are expected by one of our contacts to equal last year's pace, and to maintain this rate in 1987. Heavies are projected to be down 7 percent this year, and to stay near the 1986 pace in 1987. Realized prices on heavy trucks are down about 3 percent this year, and used truck prices have fallen substantially. Cutbacks in employment in the heavy truck industry are continuing. Announced capacity reductions would raise utilization rates in this industry from 58 percent recently to 71 percent, at current production levels. A major domestic car and truck manufacturer has cut its use of imported engines substantially, and plans further reductions.

Plant and Equipment. Except for commercial aircraft production (centered outside this District) and the auto industry, capital spending is soft. No new heavy plants are underway--auto assembly plants announced or being built are not regarded as "heavy"--but there are reports that some large new paper and chemical plants may be approved in the months ahead. Offers of free plant sites or other inducements by states, including Illinois and Indiana, continue to be reported for a planned new Fuji-Isuzu auto assembly plant. Sales of capital equipment generally remain slow. Steel castings demand is weak. A Chicago-area foundry which specialized in large steel castings, and which in the past employed up to 2,800, is being shut down because of the low volume of business. A maker of heavy-duty transmissions, in cutting employment and reducing pay of those who remain, characterized its markets as soft, with no improvement expected next year. Farm machinery sales in Iowa this year have shown improvement over very low levels a year earlier. A Chicago-area overhead crane maker has been picked to supply the Chrysler-Mitsubishi auto assembly plant being built in Illinois.

Construction. Heavy rains in parts of the District temporarily delayed construction projects. Construction will continue at a high level into 1987. The strongest rise has been in residential building, though sales have eased somewhat since last spring. Permits for residential construction in the 5 states were 24 percent above last year for 8 months, versus a year to date gain of 4 percent in the rest of the nation. Mortgage rates have fallen back below 10 percent for

30-year fixed-rate loans at some area lenders, from more than 10.5 percent typically offered last summer. Residential building District-wide is still well short of levels reached in the 1970s, and particularly low in Iowa. In the Chicago area, contracts for commercial construction for 9 months (square feet, F.W. Dodge data) were 3 percent below last year's high level. Despite large discounts being offered in some cases on effective rents, new projects continue to be announced. Suppliers expect the vigorous pace of office and retail building to continue into 1987 in some centers including Chicago.

Consumer Spending. General merchandise sales slowed in September, after a good August. Slackening in September was attributed partly to weather and strong auto sales. Buying of appliances and household furnishings has been strong. "Back-to-school" sales were the best in 7-8 years, and Christmas sales are expected to be good. Inventories are low. Demand is described as strong for other consumer goods and services, including prepared foods, soft drinks, personal care products, medical and surgical supplies, and auto repair. Airline passenger miles have been up sharply, mainly due to widespread use of discount fares. Major carriers are raising fares.

Agriculture. Heavy rains and flooding in September and early October caused extensive crop losses in some areas and significantly delayed the fall harvest throughout most of the District. Hardest hit is Michigan, with estimated corn and soybean yield losses of 6 to 10 percent from earlier forecasts, and further downward revisions likely. Losses in other crops--navy beans, sugar beets, and potatoes--range up to 50 to 70 percent in a hard-hit area in Eastern Michigan. Elsewhere in the District, if recent improved weather holds, corn and soybean harvests probably can be completed with only modest reductions from earlier projected record yields. Following three quarters of a slowing rate of decline, the downturn in District farmland values apparently steepened again this summer. Preliminary results from our current survey of agricultural bankers shows that District farmland values declined 4 percent in the third quarter, and 13 percent in the year ending September 30. Sharp reductions in crop prices since spring, and concerns about farm program legislation that might reduce federal subsidies, doubtless contributed to the escalating downturn.

EIGHTH DISTRICT - ST. LOUIS

Summary

District economic conditions have improved since the last report with stronger growth in employment, retail sales and construction activity. Most indicators of economic activity suggest more rapid growth in the District than in the nation. Real estate and consumer lending accelerated in the third quarter while commercial lending slowed. Heavy rains and flooding in parts of Missouri have damaged crops and delayed harvests and wheat planting.

Employment

District employment growth accelerated since the last report. The number of workers on nonfarm payrolls grew at a 2.8 percent rate in the three months through August, double the corresponding national rate; growth in construction employment was particularly sharp. Employment in the District's manufacturing sector continued to decline in the June-August period (2.6 percent rate), but at a slower pace than in the last report. While 14,300 workers entered the District labor force in August, total employment expanded by 30,100 allowing the seasonally-adjusted unemployment rate for the District to fall from 7.9 percent in July to 7.7 percent in August.

Consumer Spending

District retail sales in the May-July period increased at an 8.1 percent rate, outpacing the nation's 6.2 percent rate. More current reports indicate that the latest round of cut-rate financing for domestic autos, announced in late August, has dramatically stimulated sales and reduced dealer inventories. A contact in Arkansas, however, reports that payments for new autos have cut consumers' discretionary income and will reduce consumer spending in the near term.

Construction

Residential construction fell in the most recent period but still performed better in the District than in the nation. The value of contracts issued decreased by 1.8 percent in the three months through August, but was 11.9 percent above the level of the same period last year. The value of contracts fell by 2.8 percent in the nation over the most recent period and rose by 9.7 percent over the past year.

District nonresidential construction activity expanded moderately, spurred by vigorous growth in Arkansas, Kentucky and Missouri. The value of nonresidential construction contracts grew by 9.6 percent in the June-August period compared with a 1.6 percent national decline. Compared with a year ago, nonresidential contracts were 11.6 percent higher in the three-month period in the District, but 2.0 percent lower nationally.

Local contacts report that the volume of office space in the St. Louis area currently available or under construction surpasses the anticipated growth of demand for the space; thus, vacancy rates, now slightly below the national average, are expected to rise in the next few years. In the longer run, however, the recent changes in the federal tax code are expected to curtail the growth of nonresidential building and reduce excess space.

Banking

Total loans outstanding at large District banks grew at a 14.2 percent annual rate for the third quarter compared with a 5.2 percent rate for the same period last year. Third quarter activity saw an acceleration in real estate and consumer lending while commercial lending was slower. Real estate loan volume grew at a 21.8 percent rate over second quarter levels versus a 7.1 percent rate for the same period in 1985. Consumer lending also gained momentum during the third quarter, growing at a 19.3 percent rate over second quarter levels. In contrast, commercial loan volume has slackened, declining at a 0.2 percent rate primarily due to slow lending in both the Louisville and Memphis markets.

A recent survey of District banks and thrifts found that most respondents have tightened lending policies for nonresidential real estate loans. With the exception of a few savings and loans in St. Louis and Little Rock, most institutions reported low delinquency and loss rates on this type of lending but indicated increasing caution on new loans due to rising vacancy rates in some markets.

Agriculture

Recent heavy rains have caused flooding, lowered yields due to crop damage, reduced crop quality, and slowed planting of the winter wheat crop. While the extent of the damage is not yet known, most analysts expect the losses to lower total crop production only slightly. Over 50 counties in Missouri were declared disaster areas to allow farmers access to emergency federal loans.

NINTH DISTRICT--MINNEAPOLIS

The Ninth District economy appears to be poised for improvement this fall. Labor markets have tightened a bit. Major types of consumer spending have increased. Mining and manufacturing conditions have improved slightly. Government payments and big crops are expected to help agriculture. And the financial sector has adequate liquidity to finance expansion.

Employment

The most recent available data indicate that Ninth District labor market conditions are holding firm. The seasonally adjusted unemployment rate for the district fell a bit to 5.6 percent in August. At the same time, unemployment rates fell in both the state of Minnesota and its Minneapolis-St. Paul metro area, with the latter's rate falling to just 3.7 percent. In South Dakota, nonfarm wage and salary employment exceeded its previous high for August.

Consumer Spending

Major district retailers have experienced good sales levels early this fall. One retail chain notes an acceleration of activity and expects that October will prove to be its best month of the year. While another retail chain's sales slackened in October, its August and September sales were good. Neither chain reports any serious inventory problems.

District managers for domestic manufacturers of motor vehicles report "fantastic" results for September. One of them tabulates that truck sales rose 46 percent over their September 1985 level and says that its dealers already have a backlog of orders for 1987 model trucks. Another reports record monthly sales for both trucks and cars. Both manufacturers' inventory levels are low. A director of this Bank notes that used car inventories are also low in some parts of western Wisconsin.

Housing activity seems strong as well. Home sales in the Minneapolis-St. Paul area have been quite good. Sales there were 60 percent higher in September than a year earlier, making year-to-date sales more than 35 percent higher than during the same period in 1985. Multifamily housing permits in that area were 115 percent higher this August than last, and residential building contracts in the state of Minnesota grew 51 percent over that period. Bank directors also note some pickup of housing activity in the Iron Mountain area of Michigan's Upper Peninsula and in Bismarck, North Dakota.

Mining and Manufacturing

Overall, mining and manufacturing conditions have improved somewhat. A Bank director reports a little more activity in the stagnant oil and gas fields of North Dakota. Also, a big iron mine in the Upper Peninsula of Michigan is still expected to reopen in November after temporarily closing in August. The lumber and wood products sectors are benefiting from good demand, strike settlements in Montana, and a favorable trade ruling from the U.S. Commerce Department. But manufacturing employment continues to fall--dropping 1.5 percent in Minnesota between August 1985 and August 1986. Yet, some encouraging signs of manufacturing recovery have appeared. A troubled maker of tractors announced a recall of some production workers in Fargo, North Dakota. And in economically stressed Motley, Minnesota, a planned new plant employing around 140 additional workers will produce a crabmeat substitute based on surimi, which is a Japanese-invented product using Pacific whitefish.

Agriculture

Despite increased prices for hogs and cattle, the Minnesota farm price index fell 2 percent between August and September, as federal efforts continued to lower crop export prices while cushioning the blow to participating farmers. Meat animal prices were up 31 percent from year-earlier levels, though. Recent dry weather has helped the fall harvest in Minnesota. Bank directors note that the big wheat crop in northern Montana should help a lot of farmers there and that some Wisconsin farmers will benefit from one of the best cranberry crops in years. This Bank's latest survey of Ninth District agricultural lenders indicates that farmland values didn't fall as fast in the third quarter as they did earlier this year and that fewer financially stressed farmers left farming this year.

Finance

At large commercial banks in the Ninth District, total deposits grew 8.1 percent while loans grew 11.4 percent between October 1985 and October 1986. Several bankers at smaller institutions note that demand for refinancing of home and consumer loans has been strong. They report no liquidity problems, which is consistent with the slack borrowing at the district discount window. Second quarter earnings at nine of the district's largest financial service companies rose a composite 26.9 percent over the second quarter of 1985.

TENTH DISTRICT - KANSAS CITY

Overview. Little change from the recent pattern of sluggish activity in the Tenth District is evident. While housing activity remains stronger than a year ago, some recent weakening is reported. Retail sales continue to improve, but auto dealers are not optimistic about future sales. Both manufacturers' inventories of materials inputs and retail inventories are generally viewed as satisfactory. Neither retailers nor purchasing agents expect other than modest price rises. The energy and agricultural sectors remain depressed. Moderation in demand for mortgage funds at savings and loan institutions is expected to continue. Total loan demand at district commercial banks was generally unchanged over the past month.

Retail trade. Retailers report sales moderately stronger than a year earlier, with sales continuing to improve over the past three months. In the more recent period, sales of furniture, bedding and apparel have been particularly strong in most instances. Retail prices are reported to be steady. Inventories are generally regarded as satisfactory, with a few respondents trimming stocks. Sales growth is expected to continue at about the same pace, with little increased inventory growth and steady prices.

Automobile sales. Auto dealers report good to very strong sales during the last month. Ample low-priced credit has stimulated sales. Inventories of 1986 models are being reduced significantly and 1987 model inventories are growing. Dealers are not optimistic about the outlook for future sales.

Purchasing agents. Purchasing agents continue to report slightly to moderately higher prices for major inputs, but expect little further change in the period ahead. Materials continue to be readily available, and no problems with availability or lead times are expected. Inventory levels are regarded as satisfactory and little change is expected in inventory activity. None of the respondents report any production bottlenecks.

Housing activity and finance. Area homebuilders still report starts up over a year ago, but some weakening in the past month. Starts of multifamily dwellings are up less than single family starts. Most homebuilders expect housing activity to remain about the same during the rest of the year. Sales of new homes, and changes in new home prices vary depending upon location. Builders generally report good availability and steady prices of materials.

A number of savings and loan respondents have experienced light to moderate savings outflows recently, while inflows have been slight for others. Most anticipate little improvement in savings inflows until the first quarter of 1987. Demand for mortgage funds has apparently begun to moderate. This moderation is expected to continue, influenced partly by the passing of the "refinancing bulge" and by seasonal factors. Mortgage interest rates have stabilized and are expected to remain steady.

Energy. The serious slump in the district's energy industry continues despite somewhat firmer prices resulting from the recent OPEC agreement to temporarily cut output. The average weekly number of operating drilling rigs in the Tenth District was up slightly to 215 in September from 208 in August, but remains far below the 550 rigs counted in January. Exploration and development activity is expected to remain depressed as a result of uncertainty about the future course of oil prices.

Agriculture. September's record-setting rainfall hit three district states especially hard. Prolonged, heavy rainfall delayed harvest as much as 30 days in parts of Missouri, Kansas, and Oklahoma. While losses in Missouri and Kansas are expected to be minor, 20 to 50 percent of the Oklahoma wheat pasture planted after mid-September was destroyed by heavy rains. There are no estimates yet of damage to Oklahoma's cotton crop. The rainfall also delayed winter wheat planting by as much as 30 days in parts of Missouri, Kansas, and Oklahoma. In some areas, the delay means there will be no winter wheat planted this season. Livestock marketing in southwest Oklahoma was down due to the inclement weather.

Among cow-calf operations in the district, a mixed pattern of both selling and holding spring calves has emerged. Operators holding calves are doing so either to rebuild their herds, or to take advantage of cheap and plentiful feed grain. Some operators are selling calves this fall in response to favorable prices. In other cases, lenders are requiring the sale of calves for paydown of livestock loans. And in Oklahoma, some selling has occurred because wheat pasture is flooded.

Despite strong hog prices, agricultural lenders in Missouri, Kansas, and Nebraska see no signs of expansion in pork production. Hog producers, concerned about keeping current on their loans, are using hog profits to pay down debt. As long as this activity continues, the expected expansion in pork production will likely be delayed.

Banking. Total loan demand was generally unchanged and total deposit activity has been mixed during the past month at Tenth District banks. Some bankers surveyed indicate an increase in residential real estate loan demand but most report unchanged or weaker demand for these loans. Commercial and industrial, consumer, commercial real estate, and agricultural loans are also mostly unchanged or down from one month ago. None of the respondents have changed their prime rate or consumer loan rates during the last month but most expect rates to fall some by yearend. Among deposit accounts, NOW, super-NOW, and passbook savings accounts remained constant or increased. MMDA accounts were constant at most banks in the sample while other deposit categories were mixed.

ELEVENTH DISTRICT--DALLAS

The District economy appears to have stabilized after a prolonged decline, but weakness in the energy and construction sectors is hampering growth. After major declines earlier in the year, the drilling rig count is increasing slowly. The value of construction contracts is substantially below a year earlier and manufacturing remains sluggish overall. Retail sales continue to ebb, while automobile sales are increasing, owing to U.S. manufacturer incentive programs. Balance sheets of District banks continue to reflect the sluggishness of the regional economy. District farmers and ranchers face favorable income prospects for the year.

District manufacturers generally report that sales have stabilized at recent low levels, although some note further declines from weakened demand from the construction sector. Makers of primary metals and nonelectrical machinery products report flat to declining sales, and they expect demand from the energy and construction sectors to remain depressed. Electrical machinery producers note only slight sales growth and low profits. Apparel manufacturers say that prices for their products are stable while sales are flat to slightly increasing. Orders are up slightly for transportation equipment firms, particularly those producing aircraft parts. Makers of chemical and allied, and paper and allied products report that sales are unchanged overall.

The drilling rig count has again begun to turn up, after declining in September, and it is now at its highest level since May. Even so, the count for early October was less than half its year-earlier level. Regarding the potential for future activity, the two most widely followed leading indicators of drilling activity are showing divergent patterns; well permits are growing strongly while the seismic crew count has lately been declining.

Retail sales remain slow while auto sales have recently picked up as a result of national promotions by U.S. auto manufacturers. Retailers say that sales have been slower than expected and some have lowered their sales projections for the remainder of the year. Sales of consumer durables are very weak but apparel sales are strong and growing. Auto sales are strong but dealers are concerned that a sharp slowdown will occur after the incentive programs are discontinued.

The average value of District construction contracts changed little between the second and third quarters of 1986, but construction contract values are about 20 percent below last year's level. Marked reductions have occurred in office and retail building, but strength in other components of nonresidential construction has recently preserved the total value of nonresidential contracts. Past overbuilding of multifamily housing units and continued weakness in the District economy has contributed to some recent slippage in residential activity. Respondents believe further declines in multifamily residential contract values are likely, but single-family construction remains fairly steady. Single-family permits are about 15 percent below last year's level, and they have shown little change on average since the beginning of the year. Respondents indicate that lower mortgage rates have made homeownership affordable to a larger segment of the population, and that appears to be providing some stability to the single-family sector.

The balance sheets of District banks continue to reflect the overall weakness in the District economy. Total loans at large banks remain below year-earlier levels, with the sharpest dropoff occurring in business loans. Real estate loans continue to rise on a year-over-year basis, but at a decreasing rate. Total deposits at large banks remain below year-earlier levels, with particularly pronounced declines in large time deposits. While deposits at a sample of all commercial banks have also decreased, their rate of decline has been lower than that of the large banks.

Prospects for income growth in 1986 for District farmers and ranchers continue to be relatively strong. Cotton and rice farmers, despite lower market prices, are receiving large payments from government programs. Cotton futures prices have rebounded from their July lows, reflecting the reduced amount of cotton coming to the market from the government's cotton program. Government programs are less generous to grain farmers, who are receiving sharply lower prices, compared with a year earlier. District cattle producers are responding to widening profit margins by putting more cattle on feed -- up 26 percent in August 1986 over a year previous. The income outlook for all District livestock producers remains positive as feed costs fall.

TWELFTH DISTRICT--SAN FRANCISCO

Summary

Although problems in some sectors and regions continue, the Twelfth District economy appears to be improving overall. Consumer spending, particularly on new cars, continues strong. Manufacturing of aerospace products and defense related electronics continues to boost the economy, although weak business investment is hurting non defense related electronics producers and more traditional heavy industries. Weakness in world grain markets continues to trouble some farmers, but the reduced foreign exchange value of the dollar and the 1985 farm bill as well as stronger prices for many non-grain crops are improving prospects for others. Forest products companies also are benefiting from a series of positive developments, including the value of the dollar, low interest rates, strikes in Canada, and strategic decisions they made during their slow years in the early 1980s. Residential construction activity continues strong, although it has slowed from its earlier frenetic pace, while nonresidential construction activity, hurt by high vacancy rates and tax reform, weakens in most areas. Bankers report slow commercial loan demand, mostly due to overcapacity and low profitability rather than to tax considerations.

Consumer Spending

Throughout the Twelfth District, retail sales continue to provide a major source of stimulus to local economies. Tourist traffic has been strong in some areas, such as the Pacific Northwest, but disappointing in other areas, such as southern California.

Car and truck sales grew during the late summer in many areas, although several respondents attribute the strength to incentive financing and expect sales to slow when incentives stop. However, due to lingering weakness in the economies of the intermountain states, car and truck sales in Utah for the first half of 1986 were 7 percent below 1985, while in Idaho they were down 16 percent for the first eight months of the year.

Manufacturing

Aerospace and aerospace-related electronics continue to provide a source of strength in many parts of the Twelfth District, including Los Angeles, San Francisco-San Jose, Phoenix, Salt Lake City, and especially in Seattle.

However, weakness in business investment is apparent in other sectors. For example, levels of production and employment in non-defense computer related industries have declined in several parts of the West, including Oregon and eastern Washington. California's primary metals, metal fabrication, and machinery industries also are experiencing declining activity levels.

Agriculture and Resource Related Industries

In eastern Washington and southern Idaho, the fruit, potato, and bean crops are strong and exports of these products are gaining slightly. Reduced potato acreage has caused prices to improve from last year's depressed levels. Early season Washington apple prices are stronger than last year, and larger apple harvests are expected in both Washington and Oregon.

California and Arizona cotton producers are benefiting from an increased volume of cotton exports, attributed primarily to the export enhancement provisions in the 1985 farm bill. Cotton exports through the port of Stockton increased by 36 percent over last year's level. Wheat exports through western ports also have increased, but inventories remain high and world market conditions continue to be depressed.

Forest products companies in Oregon, Washington, Alaska, and northern California also are benefiting from the reduced foreign exchange value of the dollar, although there is considerable variation in the extent of benefit depending on the specific products made in each area. The increased exports have been attributed partly to the reduced value of the dollar against both Japanese and European currencies. Although the strength of the U.S. dollar relative to the Canadian dollar continues to place pressure on U.S. producers, recent strikes in Canada have helped U.S. prices and production. Throughout the District, forest products firms continue to invest in more efficient equipment and to gain wage concessions. Thus, although industry production is substantially greater than it has been for the past several years, employment and wage levels are unlikely to return to their previous peaks. As a result, the timber dependent areas of the Pacific Northwest continue to experience poor economic performance.

Construction and Real Estate

In general, residential construction continues to buoy the economies of many parts of the West, while nonresidential activity remains slow. However, there are many exceptions due to differences in local conditions. For example, in both Idaho and Alaska residential as well as nonresidential construction activity has slowed because of weaknesses in those states' economies.

Financial Sector

Several bankers reported low commercial and investment loan volumes due to low profits, low capacity utilization rates, slow consumer demand, and import competition. Interestingly, few thought that tax reform had depressed investment lending, although several expected borrowing by "investment intense" industries to slow in 1987.