SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS BY FEDERAL RESERVE DISTRICT

MAY 1987

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SUMMARY*

The economy appears to be continuing on a course of moderate expansion, according to reports gathered in April. The agricultural sector, while certainly not in the clear yet, is showing signs of improvement. Manufacturers continue to post modest gains, bolstered by growth in both domestic sales and exports. Residential construction remains strong, especially in the single-family market, and has been relatively unaffected by the recent climb in mortgage rates. Retailers are making slight gains over year-ago levels in sales of general merchandise, although auto sales are about the same as or lower than last year. Bankers say business and real estate loans are growing, but demand for consumer loans is subsiding.

The only uniformly negative reports are those on the energy industry, which remains depressed despite the higher price of oil. As a result, the regional economies heavily dependent on energy remain in the doldrums.

AGRICULTURE AND FORESTRY

Conditions appear to be improving somewhat in the farm sector. Atlanta and Chicago indicate that farmland values are stabilizing; in the Dallas and Minneapolis Districts 1987 farm incomes are expected to increase; and St. Louis and Kansas City report improved agricultural credit conditions. It should be noted, however, that no reports predict a significant overall turnaround for agriculture.

Livestock farmers are expected to benefit from a combination of lower production costs and stronger prices for cattle, hogs, and sheep. Severe

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*Prepared at the Federal Reserve Bank of Philadelphia

weather in some parts of the mid-west had an adverse effect on livestock, but the outlook there remains positive as well. Crop farmers in the southeast and mid-west have had spring field work delayed by wet weather. When planting is completed, however, acreage devoted to corn and soybeans is expected to be significantly reduced from 1986 levels. Wheat acreage should stay about even with last year's level. Cotton prices have increased significantly this year, and production is expected to follow suit. A late frost in the southeast destroyed as much as 50 percent of the peaches in that area; reports from Richmond, however, indicate expectations of a good yield for fruit farmers in that District.

Demand for lumber is growing. Atlanta reports increasing prices for southern pine; San Francisco indicates orders for lumber in the northwest are up by over 20 percent from a year ago, in part because of substantial increases in exports to Europe.

ENERGY

The energy industry remains depressed despite the higher price of oil. The number of operating rigs, while up slightly from earlier in the year, is still as much as 50 percent below a year ago. Many wells remain shut down in the Atlanta District, and reports from Minneapolis say that drilling is "almost nonexistent" in that area. Dallas, however, indicates that the rig count may be bottoming out, and that the slight growth in recent months is expected to continue.

MANUFACTURING

Most Districts indicate stable or slightly improving manufacturing sectors. Philadelphia, Cleveland, Atlanta, Chicago, and Dallas all note at least moderate growth in new orders and production. Employment gains, however, are less uniform. Industries mentioned as leading the pack include defense contractors,

chemicals, steel, and paper products. Steel and paper specifically seem to be experiencing broad-based expansion of demand, and firms in these industries in the Chicago District are reported to be operating near capacity. Lagging industries include transportation equipment (specifically domestic automobiles) and capital goods.

Industrial prices are headed up at least slightly in most areas, with rising prices for steel and pulp specifically mentioned by Boston, Chicago, and Minneapolis.

While domestic sales seem to be stronger, at least some of the improvement in the industrial sector has been related to the export market as well. Dallas reports that the falling value of the dollar on foreign exchange markets specifically has contributed to an uptick in the chemical industry. Manufacturers in the San Francisco District say the trade tension between the U.S. and Japan has helped to open markets not only in that country but in South Korea and Taiwan as well.

CONSTRUCTION AND REAL ESTATE

Residential construction and sales are reported to be strong in virtually all Districts except Dallas, where the market is adversely affected by the depressed regional economy. Elsewhere, sales are reported to be up as much as 35 percent from a year ago. Activity appears to be strongest in the single-family market; several Districts say multifamily construction is lagging. There is widespread concern that the recent jump of as much as 200 basis points in mortgage rates will choke off demand for housing. The only effect actually noted so far, however, has been a rush by buyers to close deals already in progress or to purchase property.

Office-leasing activity is reported by Boston and New York to be good. There are some pockets of excess capacity in both Districts, however, with

vacancy rates as high as 20 percent in some areas of suburban New York. Atlanta indicates that commercial construction is slow, and that some lenders are requiring pre-leasing before they approve financing for projects.

RETAIL

Most Districts report that retailers are posting "slight" or "modest" gains in March and/or April. Dallas, however, reports slow sales and San Francisco describes sales as mixed. Inventories remain generally in line with sales expectations, with neither shortages nor discounting prevalent. There have been some price increases in general merchandise as a result of the increasing cost of imports, and some retailers are trying to switch to domestic or non-Japanese Asian suppliers. Boston reports that merchants in that District are sometimes having difficulty finding domestic suppliers who can meet their volume needs.

Auto sales are running at or below year-ago levels. Sales of domestic cars are uniformly sluggish. Japanese imports show more strength but are also slow in some areas: Atlanta indicates that demand for Japanese cars remains strong despite price hikes, while Cleveland reports that import dealers in that District are accumulating unwanted inventories and are considering sales incentives.

FINANCE

Total loan volume at banks continues to grow in most Districts, fueled mainly by real estate and business borrowing. Consumer borrowing is widely reported to be weakening, a phenomenon that New York and Philadelphia attribute to the relatively high level of consumer debt and to the availability of low-rate financing by auto manufacturers. Atlanta and Richmond note that several banks have cut interest rates on credit cards recently.

FIRST DISTRICT - BOSTON

The First District economy continues to perform well. Retail sales continue to rise; manufacturers report some signs of a pickup; and with a few exceptions, the market for commercial real estate remains strong. Most First District retailers report good sales results in March and early April in spite of rainy spring weather. Inventories are not seen as posing serious problems even for those stores with sales below plan. Some merchants are being adversely affected by rising prices for imported goods. Reports from manufacturers were also fairly encouraging. In most cases, business was described as "not bad" - an improvement over the past. Increases in orders were reported for a number of products. Inventories were said to be consistent with sales. In the commercial real estate market, rapid absorption rates are holding vacancy rates to acceptable levels despite substantial space additions.

Retail

Contacts in the retail sector report recent sales increases ranging from 3 percent and "barely" ahead of last year to 25 percent ahead. The stores with disappointing sales attributed the weakness to unusual circumstances. Seasonal merchandise sold poorly because spring hasn't "sprung" in most of New England; two chains said the only product line with outstanding sales in recent months was sump pumps. One contact reported very strong March sales of VCRs and other consumer electronics, which he attributed to consumer worries about price and availability if the trade sanctions against Japan are maintained.

Contacts selling mostly American-made products report fairly stable prices, with increases of 3 percent or less. Those selling imported goods, in contrast, have experienced substantial price hikes. One respondent has been "massacred" by increases in the prices of high-quality European furniture. While trying to shift purchasing back to the United States and Canada as fast as possible, the store is having difficulty finding the necessary quality and volume. A discount department store contact has seen prices rise for both hard and soft goods from Japan; the store has raised prices but not fully, so both profits and sales volume have suffered. This store plans to cut hard goods imports by about 50 percent if comparable domestic producers can be located.

New England merchants continue to be optimistic about the remainder of the year. Those with disappointing sales have taken actions they believe will put them on an uptrend. Those with very strong sales expect to move closer to plan in the coming months, but their plans call for respectable sales growth.

Manufacturing

Reports from First District manufacturers were moderately positive. The most notable exceptions were, on the one hand, a manufacturer of fabricated metal products, primarily for consumer and housing markets, who is "euphoric" at the strength of incoming orders and, on the other, a representative of the machine tool industries who has suffered a broad-based slowing in orders. For most other respondents business is "not bad". Pickups of varying strengths were reported by producers of data processing equipment, various fabricated metal products, electronics and production equipment for the electronics industry.

Appliances and packaging were said to be doing well; and, for the firms contacted, the defense business remains strong. Demand for garden equipment was apparently hurt by the long, snowy winter. Respondents enjoying the strongest results generally saw this strength as attributable to their firms' actions rather than to an industry-wide situation. Several contacts reported strong European sales; volumes are good and when subsidiaries' earnings are converted to dollars the impact on the bottom line is significant. One contact commented that many companies may enjoy relatively strong earnings in the coming year because of the combination of currency translation gains and the effects of stringent cost controls introduced in the past couple of years.

Inventories are being watched carefully. None of the individuals contacted regarded inventories as out of line to a significant degree. Capital spending at these firms will be the same or higher in 1987 as in 1986. The emphasis is still on automation and productivity enhancements.

With respect to prices, a couple of contacts reported that they are still reducing or discounting prices in order to make sales. Detroit is putting a lot of pressure on its suppliers to reduce costs. However, one fabricated metals producer that cut prices substantially last year in response to Korean and Taiwanese competition has recently been successful in introducing an increase. Most contacts have not seen any major changes in input prices, but increases were reported for steel, castings and pulp.

Commercial Real Estate

The commercial real estate market in New England remains strong for the most part. Although new office space continues to open up in Boston, the city's vacancy rate ties that in Manhattan as the lowest in the

nation. The city of Cambridge, however, is having some difficulty absorbing a large increase in space. In Hartford there has recently been a 25 percent increase in office space, but growth in the financial services industries has kept occupancy rates healthy. In Providence two large class A buildings have become available for occupancy, but two-thirds of the space absorbed recently has been rehabbed space. In Burlington, VT rents in the suburbs are rising and vacancy rates are dropping; the area appears to be successfully attracting out-of-state tenants. A building boom in southern New Hampshire has caused a glut of office space but some analysts say that if the economy continues to grow at the current rate, demand for class A space will soon exceed the supply. Many of the projects in the region that are scheduled to open in the coming year are pre-leased. It would appear that developers are waiting for tenant commitment before beginning new projects.

SECOND DISTRICT--NEW YORK

In general, the Second District economy registered a modest improvement since the last report. Retailers had better-than-expected sales gains during March and the homebuilding season has gotten underway with a good start. Office leasing was reported to be good and general business conditions were described as stable to improved. On the financial side, small and mid-sized banks report that growth in consumer lending has been weak since the beginning of the year.

Consumer Spending

March sales at Second District department stores were reported as good despite the fact that Easter did not occur until mid-April this year. Over-the-year gains ranged from 6 to 9 percent and were generally above plan since March 1986 had included the Easter holiday. (Because of the shifting of Easter between March and April, many retailers look at the two-month period as one combined selling season.) Demand was favorable for goods such as furniture, home furnishings and housewares, though sales of apparel and accessories were relatively weak in March and stores specializing in these did not fare as well. Interest in apparel and accessories, items traditionally associated with Easter shopping, picked up substantially as the holiday grew near, and District respondents anticipate a good showing for the month of April as well.

With March sales ranging 1 to 3 percent above goals that were described as "aggressive", inventories have generally been maintained at or below desired levels. One chain with higher-than-intended stocks indicated that paring its inventories is a major objective in the weeks immediately ahead.

Business Activity

The improved tone in the District's economy continued in recent weeks. Eighty percent or more of the Rochester and Buffalo purchasing managers reporting in the March surveys described general business conditions as stable or better than in February and a modest buildup in inventories was not viewed as unfavorable.

Unemployment rates edged lower in both New York and New Jersey during March to 4.7 percent and 3.7 percent, respectively. As nonmanufacturing employment expanded further, unemployment rates remained at their lowest levels in 17 years.

With the termination of the Air Force training plane contract with Fairchild Republic in March, the long-feared closing of that company's Long Island plant is now underway. Some 1,800 of its 3,500 employees have already been dismissed and the plant is scheduled to close by year-end. A group of former employees is attempting to purchase the facility and resume aircraft production, but the success of this plan is seen as unlikely. More positive news in recent weeks was Eastman Kodak's announcement that it will build a new $200 million color film plant at its manufacturing complex in Rochester, consolidating technology it has been developing around the world.

Construction and Real Estate

As the homebuilding season gets underway, District contacts report that the market continues to look very good and demand for new housing remains strong. The recent sharp increase in mortgage rates has apparently had little dampening impact as the level of rates remains relatively low. However, shortages of available and affordable land are increasingly cited as major problems and possible deterrents to much additional homebuilding in some areas. For 1987, though, builders are expected to be quite busy and the level of activity to equal or be minimally below the 1986 pace.

Office leasing activity in the Second District has been good recently but not substantial enough to reduce vacancy rates in areas of oversupply. Rates in northern New Jersey and Fairfield and Westchester counties, e.g., remain in the 20 to 25 percent range and projects already in the pipeline continue under construction. With an overall office vacancy rate of about 8 percent, New York City is still one of the healthiest markets in the country. While it is generally expected that midtown will show some improvement in 1987, opinion is divided about the vacancy rate in lower Manhattan, where about 7 million square feet of new office space is scheduled to come on line.

Financial Developments

Small and mid-sized banks in the Second District report that growth in consumer lending has been weak since the beginning of 1987. Most banks indicated that originations of consumer installment loans, primary mortgages, and agricultural loans have slowed while demand for other types of loans, such as automobile loans, remains almost negligible. High consumer indebtedness, housing shortages, problems in the farm and dairy businesses, and competition from auto finance companies were cited as reasons for the weakness. Some bank officers reported that their applications for mortgage loans had picked up recently as other banks announced increased lending rates and consumers rushed to borrow prior to further rate increases. However, the banks which experienced the surge of activity are now raising their own mortgage rates or plan to do so in the near future. Therefore, the demand for such loans is expected to drop off at these banks and in the aggregate to fall below the usual level for this time of year. Lending officers believe that increases in home equity and unsecured personal loans will not be enough to compensate for the weakness in other forms of consumer lending.

THIRD DISTRICT - PHILADELPHIA

Most sectors of the Third District economy are making only modest gains as the second quarter begins. Manufacturing activity picked up slightly in April after being flat in March. Retail sales, while still growing as April came to a close, have slipped below retailers' plans. Bankers report a fall-off in consumer loan growth but indicate that business lending continues to grow moderately. Although mortgage markets have been upset by the recent run-up in interest rates, realtors say the usual spring surge in home sales does not appear to have been significantly restrained.

Forecasts for the Third District economy vary. Manufacturers expect only steady conditions for the next two quarters. Retailers believe sales for the spring season will be moderately above the same period last year, but they do not have any firm expectations for the second half of the year. Bankers look for continued growth in commercial and industrial lending, but expect further slackening in consumer loan demand. Realtors believe the current pace of home sales will continue through spring unless there are further increases in mortgage rates.

MANUFACTURING

The April Business Outlook Survey indicates that local industrial activity is moving up slightly again after a pause in March, continuing the stop-and-go pattern that has marked 1987 thus far. Just 20 percent of the manufacturers covered by the April survey are stepping up operations, while 12 percent are cutting back; two-thirds are operating at a steady pace. Conditions are similar in both the durable goods and nondurable goods sectors.

Although there are some positive signs this month, there is no general indication of significant strengthening in the region's industrial sector. New orders and shipments are advancing slightly, but order backlogs are slipping fractionally. Employment is also off a bit; although nearly three-fourths of the firms contacted in April are maintaining steady payrolls, 17 percent are cutting back, and only 10 percent are adding employees.

Industrial prices in the region are mostly stable. Three-fourths of the firms polled in April say input costs are unchanged from last month, and more than 80 percent report steady prices for their own products.

Looking ahead, local manufacturers forecast little change in the pace of business, although manufacturers of nondurable goods are more optimistic than durable goods makers. Overall, survey respondents expecting improvement during the next six months just edge out those anticipating a slowdown, resulting in the lowest net positive forecast since April 1980. On balance, firms participating in this month's survey project only marginal gains in new orders and shipments in the second and third quarters. They also indicate that employment prospects are not good; although half of the survey respondents intend to maintain steady payrolls, companies planning cutbacks exceed those looking to hire more workers by two to one.

RETAIL

Retailers in the Third District report that sales in April ran modestly above the same month last year, but several store officials say the year-to-year increase was slightly below their expectations. March sales, however were better than expected; thus, most retail contacts say their overall first quarter (February-April) results should be good. Sales estimates for this period range from 3 to 10 percent above the year-ago period. Seasonal items,

apparel, and jewelry are selling well; and the relatively higher margins on these goods are bolstering retailers' profits for the quarter.

Store executives believe the current pace of consumer spending in the region will continue for the next several months, which is as far ahead as they feel confident to forecast. They say continued good performance in the region's retail sector depends on a generally healthy local economy and continued job and population growth in parts of the Third District, such as central and southern New Jersey, where some of the area's major retailers are planning new stores.

FINANCE

Bank lending in the region, on net, has grown little since the beginning of the year. Total loan amounts outstanding at major Third District banks in early April were up just over 1 percent from December's levels. The slackening growth in total lending is almost entirely due to a slowdown in consumer loan growth in recent months. Bankers contacted in late April say that credit card and other consumer installment loan volume is flat or down compared to 1986 year-end. Although bank credit officers say some of this slowdown is due to consolidation of personal loans under home equity credit lines, they believe that total personal lending is growing more slowly, however it is classified. They say that the long-predicted retrenchment in consumer spending may have begun, and they expect a slower rate of retail sales to result in an easing of consumer credit demand.

Commercial and industrial loan volume at large Third District banks is up around 5 percent from the beginning of the year. Bankers say this rate of growth may slip somewhat in the near term, as the current economic expansion ages, but they expect lending to companies in the region to grow at close to its current pace for the rest of the year.

REAL ESTATE

Residential real estate activity is picking up, as is usual in the spring, according to realtors. They believe the recent run-up in mortgage rates will not significantly reduce home sales, although higher rates may restrain rising home prices. Most realtors in the region say that sales should continue at a brisk pace as long as rates do not go much higher.

The average rate on 30-year conventional mortgages in the region has increased from approximately 9 percent in March to over 10 percent in late April. Mortgage lenders say the general increase in bond rates has affected the pricing of mortgage-backed securities, causing them to raise mortgage contract rates. In addition, lenders say, home buyers are more likely to take down mortgages for which they have commitments when rates rise. Consequently, individual lenders seek more funds to be certain of covering mortgages to which they are committed. The aggregate result of this is upward pressure on the cost of funds for the industry as a whole. Nevertheless, there is not a widespread feeling in the region that mortgage rates will continue to rise; one large mortgage lender in particular believes rates will decline to 9-9.5 percent soon and remain in that range for the rest of the year.

FOURTH DISTRICT - CLEVELAND

Summary

The region's economy continues to expand slowly. Many respondents are optimistic about prospects for the second quarter. Production, new orders, and employment are reported to be higher in March than at any time this year. While retail sales are sluggish, housing construction and sales of existing homes remain relatively strong. However, there is immediate concern that the jump in interest rates may dampen the real estate market.

Retail Sales

Retailers reported a slight growth in sales in March. Although home furnishings and other hard goods were stronger than some retailers expected, unusually harsh weather in March slowed sales of spring apparel and other soft items. However, the late Easter season and more seasonal temperatures are expected to help sales rebound in April. Projections of price changes over the course of the year are the same as the January predictions of a 2 to 3 percent annual rate of increase.

March automobile sales are on par with sales a year ago. However, dealers are still feeling the effects of the 1986 incentive programs and tax law changes as current sales remain sluggish. Domestic dealers expect moderate price increases (2 to 3 percent) as a weak dollar forces import dealers to increase prices. The increase in inventories of Japanese-built cars have prompted some Japanese automakers to consider sales incentives.

Labor Markets

Ohio's unemployment rate rose 0.3 percent from January to 8.6 percent in February, which is the same level as a year ago. Toward the end of last year,

it appeared that the state's unemployment rate was converging toward the national rate, but since then unemployment has steadily increased, as the estimated number of workers entering the state's labor force outpaced the number employed.

Total employment in Ohio grew by only 4,000 jobs (.09 percent) from January to February. Services continued to dominate the increase in jobs. In February service employment increased by 7,000 while manufacturing employment grew by only 1,400. The trend toward services is even more dramatic over the last year: 56,000 additional workers were employed in services, while 12,000 fewer workers were employed in manufacturing.

Average weekly earnings of production workers declined by $2.68. This decline was due entirely to a reduction in the length of the average work week.

Manufacturing

A survey of purchasing agents in Ohio revealed that production, new orders, and employment were higher in March than in previous months. Although inventories were also rising, it was generally felt that the strength in production was not due to a short-lived inventory buildup but rather to new orders and a larger backlog of orders. Exports accounted for only a small portion of the increase in orders. One area of concern was the increase in prices. Commodity prices continued to climb at a rate which was twice the three-year average. Service prices were also increasing. Some respondents expressed concern that prices are increasing faster than productivity improvements.

Raw steel production in Ohio increased 17.5 percent during March. Much of this increase was presumably due to new orders since inventories continued

to decline in recent months. The rate of capacity utilization was at its highest level in over a year, which may help to explain the increase in prices of many types of steel products.

Housing

The fall in conventional mortgage rates in March to the lowest level in nine years continued to fuel the Ohio housing market. Building permits for single family housing units increased an average of 25 percent over last year in many of the major cities in Ohio. Sales of existing homes also increased substantially, jumping 31 percent in Ohio in 1986 from the previous year.

With fixed-rate mortgage rates increasing as much as two percentage points in the past month, there is concern that the recent boom in the housing market may be short-lived. One loan officer that we contacted indicated that the number of new loan applications is down 75 percent from the high a month ago. He feels that many potential home buyers are taking a "wait and see" attitude before locking in at the current interest rate.

Banking

District loan demand has improved somewhat in the last month. Total loans outstanding at large banks rose at an annual pace of 14 percent over the last seven weeks. This lending compares favorably to the decline in loans in late January and February. Loan growth has been concentrated in business and real estate loans, reflecting moderate business loan demand and the popularity of home-equity credit. Although consumer installment lending continues to subside, the volume of consumer and real estate loans collectively has been growing at an annual pace of around 6 percent.

FIFTH DISTRICT - RICHMOND

Summary

Production and retail activity increased in the past month, and producers and retailers continue to be optimistic about the economic outlook. In financial institutions, credit card rates are falling and mortgage activity is stronger although mortgage rates are up sharply. District farmers are behind in spring planting because of heavy rains.

Manufacturing

Manufacturing activity increased during the past month according to our April regional survey. About 40 percent of manufacturers reported increases in shipments and new orders over last month, as compared with about 20 percent who reported declines. These results are about the same as those from our previous survey, suggesting stable growth. Manufacturers also reported increases in backlogs of orders, number of employees, and hours worked per week. Inventories of materials are generally unchanged while inventories of finished goods are slightly lower. About half of the manufacturers plan to hold inventories at current levels over the next six months; the other half are about evenly split between those planning increases and those planning decreases.

Machinery manufacturers reported an increase in activity, the first such report this year. Their capacity utilization rate has risen 5 percentage points since our previous survey, and now stands at 61 percent. Activity in the region's textile industry apparently declined from a month ago, breaking a series of increases. Activity increased again in the apparel industry.

The percentage of manufacturers reporting price increases continues its trend upward. Forty-four percent of the firms surveyed reported increases in the prices they pay for materials, and 18 percent reported increases in the prices they charge for finished goods. Figures from the previous survey were 35 and 15 percent, respectively.

Looking ahead six months, manufacturers expect business conditions to continue to improve, although they have tempered their optimism somewhat since our previous survey.

District coal production so far this year is about 10 percent below what it was last year, and steam coal producers are concerned about a large potential increase in imported coal.

Consumer Spending

District retail sales rose from March to April. About 60 percent of the retailers reported increases in sales and about 20 percent reported decreases--percentages almost identical to those from the previous survey. Among subgroups of retailers, 80 percent of the department stores reported increases in sales, while most automobile dealers reported declines.

In general, retailers are optimistic that business conditions will improve over the next six months. Retailers continue to accumulate inventory, as evidenced by the 42 percent reporting increases in stocks compared with only 8 percent reporting decreases.

Services

District service activity increased in April. Sixty-three percent of the service firms surveyed reported increases in sales over last month while 7 percent reported declines. Similarly, 68 percent expect their sales to increase in the next six months while 15 percent expect declines.

Financial

Several District banks have reduced rates on credit cards. Home equity loan demand continues to be strong, and financial executives report that activity in fixed-rate home mortgages has also increased since mortgage rates jumped in mid-April. In late April, mortgage interest rates averaged 100 basis points and one discount point above month earlier levels. Bankers and others close to the residential real estate market believe that mortgage loan activity will remain strong for the near future as households rush to close these loans in expectation of even higher rates to come. Homebuilders are concerned about mortgage rate increases, but so far the District housing market remains strong.

Agriculture

Rain has been heavier than usual for this time of year across the District, which has delayed land preparation and planting. District farmers expect to plant less acreage in major field crops this year. Corn acreage will decline by almost 7 percent from a year ago, and soybean acreage will fall 10 percent. Wheat acreage is expected to be unchanged. Surveys of peanut and tobacco farmers indicate that they plan to increase the acreage planted in these crops, but the high variability of yields in peanuts and tobacco limits the usefulness of planting intentions as a basis for forecasting production. In fruit orchards throughout the District, high bloom and bud counts give promise of good yields this year.

SIXTH DISTRICT - ATLANTA

The region's economic indicators continue to show signs of expansion for most non-energy related sectors in early spring. Output and employment are increasing for key regional industries such as textile, aerospace, and building products. Easter retail sales were favorable, but strength in auto sales was limited to imported vehicles. District building permits increased, and builders anticipate vigorous spring construction. International tourism is up, and rising imports are still boosting port activity. Less positively, farmers will reduce plantings, and the peach crop was severely damaged by cold weather. The petroleum and coal extraction industries remain at a low ebb with little reason to expect improvement at least for the near term.

Employment and Industry. Manufacturing activity continues to advance in the region. A record volume of direct foreign investment, largely in plants producing consumer goods and auto parts, is boosting manufacturing employment.

For the first time in years, textile industry spokesmen have a positive outlook for their sector. After a shakeout in which many weaker firms either went out of business or were absorbed by stronger firms, profits and orders are rising, and employment levels are increasing. Defense spending also continues to bolster employment in the region, helping to maintain the Southeast's manufacturing jobs near a record high level. For example, two large aerospace companies have announced major contracts for the middle Georgia area, which are expected to spawn over 30 satellite industries to service the contracts.

Demand appears to be holding up for the building products industry, although industrial spokesmen are concerned about the recent rise in mortgage interest rates. Paper packaging manufacturers report brisk business with hefty order backlogs.

Consumer Spending. Major southeastern retailers report that Easter sales met their expectations for good performance. Lean inventory levels reduced the need for Easter price promotions, but retailers are now finding it more costly to rebuild inventories as a result of the falling dollar and the recently imposed tariffs on electronic items from Japan.

District car dealers reported mixed sales behavior through mid-April; softening demand for some domestic models was partially offset by continued growth in sales of imported vehicles. Despite price hikes, imports continued to fuel much of the activity in dealers' showrooms.

Construction. Single-family building permits increased in the Sixth District in February after a four-month decline, leading builders to expect a strong upturn in construction this spring. The recent hike in the mortgage rate spurred an immediate rush by consumers to complete housing purchases; an Atlanta realtor reported a doubling of business the first weekend following the rise in rates, although business has since slowed as consumers await further indications of interest rate direction. Lenders are unwilling to make rate commitments beyond a few days.

An oversupply of space still plagues the Sixth District's commercial construction industry. Atlanta developers say speculative building is very slow, and lenders require substantial preleasing when financing new projects.

Financial Services. In March, total loans at the District's larger commercial banks grew at 18 percent for the third consecutive month. Competition for commercial and home equity loans is unusually strong in Miami and Nashville. Bankers in Miami are poised for another round of reductions in credit card rates. None of the major Florida banks have lowered their rates yet, but cuts are possible considering recent reductions in a few Georgia banks and lagging outstanding credit card balances due to the popularity of home equity lines. Credit card delinquency rates and bankruptcies have jumped sharply in some of the most rapidly growing sectors of the District.

Tourism. The arrival of spring break again brought an influx of students to the beaches of Florida. A record number of college and high school students flocked to Daytona Beach; however, contacts in Fort Lauderdale report a 20 percent decline in student visitation this year. International tourists, whose numbers appear to be on the rise, find Florida a prime attraction.

The falling dollar apparently has not yet improved trade activity at District ports. In New Orleans, for example, import volume continues to climb stubbornly. Port officials report that much of the recent tonnage increase there is due to rising imports of auto parts from Brazil, bagged fruits from the Caribbean, and steel and ore products from various countries. Except for forest products, exports are less than expected. An improving trade volume through Florida's ports is principally attributable to rising exports to the gradually recovering economies of Latin America.

Agriculture, Forestry, and Mining. Fewer oil drilling rigs were in operation in the District in March than any time in the past decade. Active rigs in the District number only 56 percent of those a year ago. It is unlikely that future production will return to past levels as many stripper wells have been closed and are unlikely to resume operation. District coal production in the first quarter of 1987 averaged 12 percent less than a year ago. Industry spokesmen indicate coal prices and profits will remain low until supply is more clearly in balance with demand.

In the agricultural sector, land values appear to be stabilizing. Georgia, Florida, and Tennessee experienced modest increases in average prices during the past year, while Louisiana and Mississippi suffered further severe declines. District farmers intend to cut planted acreage by an additional 9 percent this year, further shrinking the prospective demand for products of farm suppliers. A late freeze eradicated about half of the region's peach crop.

The lumber industry reports that southern pine is selling at prices 14 percent above a year ago, reflecting a combination of influences including the Canadian export tax on lumber, rainy weather reduction in local production, and strong residential housing demand.

SEVENTH DISTRICT--CHICAGO

Summary. Reports on activity in the Seventh District generally indicate further expansion. An exception is the auto industry, where lagging car sales have led to production cuts and layoffs. Truck sales are ahead of last year. Purchasing managers report further expansion. Steel markets have been stronger than expected. Most lines of capital goods remain slow. Nonresidential construction has been at good levels in the District, but some slowing in commercial work is reported in the Chicago suburbs. Residential building and sales continue strong. Paperboard shipments from Midwest mills have been above expectations, probably due partly to inventory building. Apparent slowness in March sales at a large retail chain store were attributed to the late Easter. Returns to District crop and livestock farmers have improved, and the five-year downtrend in farmland values shows signs of bottoming.

Motor Vehicles. Sales of domestic-model cars have continued below a year earlier, and production plans have been adjusted downward in response. Production cuts are concentrated among long-time domestic automakers, and are being accomplished in part by layoffs at some District plants. Temporary and permanent layoffs by automakers are particularly a concern in southeast Michigan where the industry is heavily concentrated. Assemblies are sharply higher at U.S. plants of foreign producers located outside the District. Truck sales have been strong, and forecasts for total truck sales this year have been revised up. Industry analysts expect production of heavy trucks in 1987 to exceed 1986 by 5-10 percent.

Purchasing Managers. Chicago and Milwaukee purchasing managers report rising activity this year through March. Production, orders, backlogs, and inventories have risen. Lead times have lengthened. Expanding activity has been accompanied by continuation of the price increases which began last fall.

Steel. Demand for steel in the second quarter has been stronger than analysts anticipated early in the year. USX's gradual return from a six-month work stoppage

was expected to put downward pressure on steel prices. This is not occurring. Rebuilding of inventories and reduced imports are thought to be important factors in the strength of steel demand. District producers of sheet steel are operating at around capacity. Bookings for the third quarter are not showing the usual seasonal downturn. Auto industry demand is holding up well despite softness in sales. Buying by appliance makers has increased. Steel service center business is strong. Demand for steel used in gas pipelines is strong. Orders are also up for steel used in oil and gas drilling and railcars, lines in which demand had been very low.

Capital Goods. A producer of a variety of industrial products reported that activity is flat to down. Demand for castings remained slow. Markets for food service and commercial refrigeration equipment were held down in part by the ample availability of used equipment. A District producer of railroad locomotives, which had planned recalls of laid-off workers if orders picked up, changed the status of 1,200 on layoff from temporary to indefinite. A large farm equipment maker is paring its salaried work force by a further 5-6%, following huge cuts earlier, in an effort to return to profitability even if demand stays depressed. Aircraft components, both civilian and military, are in strong demand.

Nonresidential Construction. The pace of nonresidential construction in the District has been ahead of the U.S. in 1987. Contracts (floor area) in the five states were 6% above last year for two months, versus a 12% decline nationwide. Construction steel fabricators reportedly are busy in several Midwestern states. A large amount of work is underway in downtown Chicago, with more announcements expected, but some softening is reported in the suburbs. Ready-mix concrete prices have fallen, attributed partly to the mild winter which allowed projects to be finished months ahead of schedule.

Residential Construction and Sales. Home construction and sales remain strong in the District. However, the jump in mortgage interest rates in April may dampen

activity. Chicago-area quotes on 30-year fixed-rate mortgages vary widely, from around 9.5% up to 10.75%. A month ago, 8.75-9% was common. A large Chicago-area realtor reports that the number of its residential sales transactions in March was the second highest ever, below record 1986.

Paperboard. Paperboard shipments in 1987 have exceeded expectations. For 2 months, shipments from mills in the North Central states were 3% above a year earlier. Based on a District company's experience, March data for the industry are expected to show another increase. Strength is attributed in part to increased inventories of finished appliances and nondurables in boxes. Brown paper mills are operating near capacity. Producers have announced price increases averaging 9%.

Retailing. A contact with a large District chain store reports that March sales were weak, except when special incentives were offered, but April is expected to be well above a year earlier because of this year's late Easter shopping season. Some orders have been shifted from Japanese to other Asian suppliers in response to the high value of the yen, but this shift is "glacial" because of long-term contracts.

Agriculture. Conditions are improving in the District's deeply distressed farm sector. Corn and soybean prices have edged higher because of unexpected strength in exports and domestic consumption, and indications that farmers intend to cut 1987 crop acreage more than had been expected. A survey of planting intentions indicates that District farmers plan cuts of 13 percent in corn acreage and 4.5 percent for soybeans. Livestock producers continue to fare well, aided recently by seasonal increases in hog and cattle prices. In marked contrast to the downtrend of the past five years, District farmland values, on average, held steady in the first quarter. Modest first-quarter gains ranging from a half to one percent in Illinois, Iowa, and Michigan were about offset by declines of 1 percent in Indiana and Wisconsin. Farm real estate activity is up from a year ago in all District states.

EIGHTH DISTRICT - ST. LOUIS

Summary

Overall economic activity in the District continued at a moderate pace. Employment and nonresidential construction growth accelerated since the last report, while residential construction continued to grow rapidly. Retailers report generally moderate sales gains in March and April. The agricultural sector continues to shrink as planted crop acreage is expected to decline for the third consecutive year. Bank lending during the first quarter grew at a faster pace than during first quarter 1986. Some of the District's large banks reported lower earnings as loans to Brazil and Ecuador were placed in a non-accrual status.

Employment

District nonfarm employment grew at a 4.8 percent annual rate in the three months through February compared with the nation's 3.2 percent rate. All major sectors of the region's economy expanded during the period. Manufacturing employment grew at a 3.3 percent rate. Employment in the food processing and textile/apparel sectors continued to grow rapidly, while employment in the production of transportation equipment continued to decline.

Consumer Spending

Reports from major retailers in the District's metropolitan areas suggest that sales of general merchandise in March and early April

were moderately above the level of the same period last year, but were not as strong as the February gains. February tax revenue data suggest that auto sales volume was down 19 percent from February 1986 in Arkansas while up moderately in Tennessee.

Construction

Residential building in the District continued to grow rapidly in the first quarter, matching the nation's growth. The value of residential construction contracts grew 13.7 percent in the first quarter compared with a 15.1 percent gain in the previous quarter. Much of the District's residential growth continues to be concentrated in the St. Louis area.

The value of District nonresidential contracts accelerated in the first quarter, increasing by 5.5 percent, following a 7.5 percent drop in the previous period. Nationally, nonresidential contracts were also up 5.5 percent in the first quarter.

Agriculture

Recent survey information points to a continued shrinkage of the District's agricultural base. Total harvested acres in Arkansas, Kentucky, Missouri and Tennessee fell by 4.7 percent in 1986 following a 5.5 percent reduction in 1985. Estimates of farmers' planting intentions for 1987 indicate a 7 percent decline in planted acres from 1986. This compares with an 8 percent decline in planted acres nationally. Intended acreage of soybeans and corn, the District's two most important crops, were 11 and 17 percent lower than plantings in 1986. Cotton is the only major District crop expected to increase in planted acreage (up to 9

percent). Farmland values continued to decline in all District states with the exception of Tennessee where they were up by 2.0 percent in 1986. The largest decline occurred in Arkansas where values were 10.1 percent lower for the year.

Agricultural banks in the District showed improvement in 1986 in all measures of bank performance. Nonperforming farm production loans decreased from 7.6 percent of total farm production loans to 7.0 percent and loans charged-off at agricultural banks decreased from 2.0 percent to 1.8 percent of all loans. The return on assets at District agricultural banks increased from .80 percent in 1985 to 1.02 percent in 1986.

Banking

Total loans outstanding at large District banks grew at a 13.7 percent annual rate for the first quarter of this year compared with 9.0 percent growth for the same quarter in 1986. Commercial loans, increasing at a 16.1 percent rate over the quarter, far outpaced the 6.2 percent growth recorded for first quarter 1986. Real estate loans expanded at a rate twice that recorded for first quarter 1986, growing at a 26.7 percent annual rate.

Problem loans in Brazil and Ecuador lowered first quarter profits at two of the District's largest banks. One large St. Louis bank placed $69 million in loans to these countries on non-accrual status.

NINTH DISTRICT - MINNEAPOLIS

The Ninth District's economy has improved slightly. Employment conditions have improved a bit. Consumer spending has been stable, with home spending continuing strong in metropolitan areas and tourist spending expected to pick up in rural areas. Some signs of improvement have also been noted by observers in agricultural areas. Resource-related industries, however, turned in a mixed performance.

Employment

Employment conditions improved slightly during the first quarter. In Minnesota, total employment in March rose to a level 3.1 percent higher than a year earlier, bringing the state's March unemployment rate down to 5.1 percent. Another indicator of strength was Minnesota's falling level of initial unemployment claims, which fell in February to 9 percent below its year-earlier level. In South Dakota, employment grew and unemployment rates declined as well. Around both Sioux Falls and Rapid City, unemployment rates are lower than 5 percent. North Dakota and Montana, both dependent on resource-related industries, fared less well: they continued to experience higher unemployment rates than in the rest of the district.

Consumer Spending

For the most part, spending on general merchandise held steady. One retailer reports that, so far, April sales have been good: its inventories are in line with sales and its retail credit quality is stable. One Bank director notes that while many Montana retailers are still stocking inventory on a break-even basis, some retail growth has occurred in the Great Falls area. And scattered reports indicate stable retail sales in Dickinson, North Dakota and Billings, Montana.

Sales rates for motor vehicles continued to moderate from the rapid pace set last year. Reports from zone offices of domestic manufacturers show that district car and truck sales were only 0.1 percent higher early in April than they were a year earlier. One domestic manufacturer notes that its inventories are now too high; still, its district car sales were 7 percent higher this March than last. Domestic manufacturers also expect the falling yen-dollar ratio to aid sales further, as American buyers purchase domestic vehicles instead of Japanese ones. Other sources indicate that auto sales have slowed in agricultural areas of Montana and North Dakota.

Warm weather and reasonable financing continued to aid housing activity in the district. In the Minneapolis-St.Paul metro area, homes again sold briskly. For example, Minneapolis home sales in February exceeded year-earlier sales by nearly 35 percent and, in March, by 40 percent. In the metro area, single-family housing permits (an indicator of future sales) posted a 50 percent gain in February, compared to a year earlier. But multifamily housing construction declined in the metro area. Homebuilding is still slow in the oil patches of western North Dakota and Montana.

Harbingers of increased tourist spending are evident to observers of the tourist industry. The increasing popularity of historic forts is expected to help western North Dakota, hard hit by the oil and gas slump. In South Dakota, inquiries about summer travel are running 13 percent higher than last year. In Montana, inquiries are up 28 percent so far, and they are also up in Michigan's Upper Peninsula.

Agriculture

Some guarded optimism is being expressed in some of the district's agricultural areas. One Bank director reports that conditions in eastern North Dakota have improved. Land values there have firmed and production

costs are lower. Another Bank director notes that soil moisture in Montana is mostly adequate, despite light snow coverage this winter. In March, beef cattle prices reached their highest levels in Minnesota since September 1980. Mostly mild winter conditions also helped cattle ranchers in Montana. While hog prices have dropped some recently, they are still above their levels a year ago. In fact, a new hog-raising operation is just starting up near Pierre, South Dakota.

This Bank's first-quarter survey of rural bankers also indicates some improvement in farm conditions. Many of the surveyed bankers believe that net farm income in their areas was higher in the first quarter than a year ago, citing lower production costs and higher government payments for the improvement. Especially helpful to farmers were advance deficiency payments and increased participation in the Conservation Reserve Program. The surveyed bankers also indicate that the rate of farm foreclosures has lessened somewhat.

Resource-Related Industries

The performance of the district's major resource-related industries was mixed. Producer prices for pulp and newsprint rose, while prices for lightweight coated and supercalendered paper fell. A mill in northern Minnesota is filling a need created by earthquake damage to a newsprint mill in New Zealand. The lower dollar has also helped quell imports of foreign newsprint. In contrast, drilling in the district's oil-producing areas has been almost nonexistent, with only six new rigs operating in North Dakota's Williston Basin. This has prompted that state to lower taxes on extracting oil from new wells.

Tenth District - Kansas City

Overview. Only slight improvement is evident in Tenth District economic activity. Retail sales, including auto sales, continue to improve modestly. Retail prices have been relatively stable and are expected to remain so, but manufacturers' purchasing agents report moderate increases in input prices and expect further increases. Retail inventories are satisfactory, but manufacturers are trimming their inventories. Housing starts remain at the level of recent months. The energy sector shows little significant recovery in spite of firmer oil prices. Savings institutions report recent strength in loan demand due mainly to mortgage refinancing and home equity loans. Deposits at banks are generally constant or up slightly, while loan demand varies across banks. The agricultural credit picture appears somewhat brighter.

Retail Sales. Tenth District retailers report that sales are generally above year-ago levels. Retail sales also have improved slightly during the last three months. Prices have changed little during the last three months and are expected to remain relatively stable. Inventory levels are satisfactory, but continue to be monitored closely. Most retailers are optimistic that sales will be solid during the rest of 1987.

Automobile Sales. Automobile dealers report that sales were slightly stronger in March. Inventories are generally high, however, and most dealers are attempting to cut their stocks. Adequate financing was available for both dealer inventories and customer sales. Nevertheless, most dealers expect sales to decline from recent levels.

Purchasing Agents. Purchasing agents report moderate increases in input prices during the last three months, and expect small price increases during the next three months. Most materials are readily available, but some

purchasing agents report longer lead times for such inputs as lead and steel. Firms are trimming their inventories slightly and plan to continue trimming in the near future.

Housing Activity and Finance. Area homebuilders report that good weather has allowed housing starts to remain at or slightly above last year's levels. Housing starts are also about the same as last month. Single-family home construction has been stronger than multifamily construction, with the greatest strength in more expensive custom homes. Sales have generally been in line with expectations, and new home inventories are not causing undue concern. Home prices are stable to slightly higher. Builders have had no unusual problems obtaining delivery of construction materials, and materials prices have been relatively stable.

Many savings institutions in the Tenth District have experienced weak deposit growth during the last year. In many cases, institutions have not competed aggressively for interest-sensitive deposits because of limited lending opportunities. The recent uncertainty surrounding recapitalization of the FSLIC has also dampened deposit inflows. Loan demand has been stronger recently because of mortgage refinancing and home equity loans. Mortgage delinquency and foreclosure rates are finally improving somewhat in the Tenth District. Most respondents believe the recent surge in mortgage rates is temporary and that rates will return to their former levels.

Energy. Significant recovery in the district's energy industry remains elusive, despite firmer recent oil prices. Exploration and development activity remains generally depressed. The average weekly number of operating drilling rigs in the Tenth District increased from 223 in February to 249 in March, two-thirds of the number recorded a year earlier and only 16 percent of the peak number reached in 1982.

Agriculture. Winter wheat conditions vary widely across the district. Many areas are expecting an average harvest, but a wet fall significantly reduced plantings in some regions and recent spring storms have caused crop damage in a few areas. The wet weather has also brought spring field work to a temporary halt across much of the district. Severe weather also had an adverse effect on livestock in some parts of the district. Some farmers and ranchers experienced significant death loss in their spring calf crop due to the cold and snow. Bankers do not expect the losses to affect the overall livestock outlook for the district.

The agricultural credit picture in the district is somewhat brighter this spring than in past years. With 90 to 100 percent of loan arrangements completed, it appears that less than 5 percent of borrowers will be denied credit this spring--a marked improvement over the last several years.

Banking. Total loan demand was mixed, and total deposit activity was generally constant or up at Tenth District banks during the past month. The number of bankers reporting an increase in loan demand was equal to the number reporting a decrease in loan demand. The prime rate either remained constant or increased slightly at all reporting banks, and is expected to remain constant or increase slightly in the near term. Consumer loan rates generally remained constant, and few bankers expect changes in the near term. All categories of deposits except large CD's generally remained constant or increased. Large CD's were mixed with the number of bankers reporting an increase equal to the number reporting a decrease.

ELEVENTH DISTRICT--DALLAS

The District economy remains sluggish overall, but some important sectors are showing signs of renewed strength. Despite flat to declining sales by producers tied to energy and District construction, most manufacturers report slight increases in orders. The drilling rig count has resumed its gradual growth. Construction activity is declining. Retail sales generally remain weak, but auto sales have rebounded from very low levels. The balance sheets of District banks continue to reflect the region's sluggish economy. Product prices for District cotton producers and cattlemen are increasing.

Although District manufacturers report no increases in employment, many say that orders are increasing somewhat. Defense-related manufacturers cite increased military contracts and expect output to be strong for the next two quarters. Producers of steel note expansions in orders and anticipate continued strength through this summer. The falling value of the dollar is said to have contributed to increased sales by chemical producers. Semiconductor manufacturers report a pickup in orders and expect further growth. Sales by manufacturers of construction-related durables continue to decline. Some producers have partially offset these reductions by broadening their markets to include regions outside the District. Orders in the energy-related durable goods industries seem to be bottoming out.

The drilling rig count in the District states resumed its gradual upward movement in March and the first half of April, on a seasonally adjusted basis, after falling slightly in February. Despite the recent

weekly increases, drilling activity remains below a year earlier, but year-over-year rates of decline have diminished. Leading indicators of drilling activity suggest that the rig count will continue to edge upward. Texas well permit applications increased substantially in February and the seismic crew count rose modestly in March.

Indicators of construction activity in the District states declined in the first two months of 1987 from the fourth quarter of last year, on a seasonally adjusted basis. The values of residential, nonresidential, and nonbuilding construction contracts all fell appreciably, resulting in a 7-percent decline in total value. Both single-family and multifamily housing permits also dropped considerably over this period. These recent declines contributed to an 28-percent drop in single-family housing permits and a 86-percent drop in multifamily housing permits from the first quarter of 1986. No respondents expect a turnaround in this sector anytime soon.

Retail sales remain slow because of continued weakness in the regional economy. Respondents say that sales in areas of the District more directly dependent on the energy sector have not yet begun to rebound significantly from their very poor performance in 1986. Sales in some less energy-dependent areas of the District are softening. Retailers report paying stable to slightly increasing prices for the products they buy, but competitive pressures are inducing them to lower the selling prices of some goods. Most respondents expect weak sales for the next few months.

District auto dealers report that, although the traditional March upswing in automobile sales has occurred again this year, sales remain below year-earlier levels. Nevertheless, respondents say the sales

increase is especially welcome this year because it did not depend on broad incentive programs and because it follows very disappointing volumes in both January and February. Inventories are somewhat high and dealers are not optimistic about sales growth in upcoming months.

The balance sheets of large District banks reflect continued difficulties in the wake of the regional economic downturn. Business and real estate loans are declining, while securities holdings are increasing. Deposits are still falling, led primarily by reductions in large time deposits but also by declining transactions deposits. Borrowings remain far above year-earlier levels. Deposits at thrifts are climbing, but the rates of increase dropped off substantially throughout the first quarter.

Despite lower prices for some commodities, District farm and ranch incomes in 1987 are expected to increase over last year's. Cotton prices have generally increased substantially. Prices for the lower quality cotton that constitutes most District production have risen at particularly high rates. Government programs have reduced the acreage expected to be planted to cotton in Texas by 3 percent, but soil moisture conditions are extremely favorable, so this year's production could be large. Slaughter steer prices have reached $70 a hundredweight up from $55 a year ago, while feed grain costs have declined by about 30 percent over the same period.

TWELFTH DISTRICT -- SAN FRANCISCO

Summary

Most developments in the Twelfth Federal Reserve District have been positive, despite lingering weakness in some sectors and regions. Consumer spending activity varies with local economic activity, as the prosperous, and generally urban, parts of the District report strength, while many rural and inland areas report weakness. Manufacturers report that improved exports have boosted orders and sales. Farmers' fortunes are mixed, as prices of some agricultural products have risen while other prices continue to decline. Lumber producers continue to benefit from strong domestic and foreign demand. In most parts of the District, single-family homebuilding is expected to remain strong, with little change from last year's robust pace. As bankers' cost of funds has risen in recent weeks, many banks have increased their loan rates and most others expect to implement rate increases on some instruments soon.

Consumer Spending

Retail sales activity has been mixed in the West. In regions that are healthy economically, such as California, sales growth continues, and sales of both imported and domestic cars have been strong. Utah, where economic activity has been relatively stagnant, presents a sharp contrast. March retail sales were reported to be down 3 to 4 percent from their year-earlier level, and auto sales, while up from March, still stood substantially below their year-earlier level.

Manufacturing

Respondents expressed concern about the potential detrimental effects of a trade war with Japan. Japan is by far the most important export market for western products. One Arizona electronics manufacturer exports about 30 percent of its

product to Japan. U.S. companies that have shifted manufacturing activities to Japan also expressed concern about the potential impact of more stringent tariffs.

At the same time, some argue that the escalating trade friction has opened up Japanese markets to U.S. firms. In addition, both Taiwan and South Korea, fearing possible retaliatory actions against them, have taken significant steps to reduce tariffs and duties on a large number of items. Moreover, Japanese firms can be expected to continue shifting more production to the U.S., with California a prime candidate for that investment. Finally, if allegations about semiconductor "dumping" are true, and if U.S. trade measures curtail dumping, western electronics firms should benefit.

Agriculture and Resource Related Industries

Prices for cattle and sheep have increased and reportedly are reaching profitable levels. However, ranchers remain cautious because higher prices tend to attract foreign imports in both markets. Prices of apples, potatoes and milk also have risen. Wheat prices, while up slightly in recent months, remain 22 percent below their year-ago levels. Weakness in hay, grain, and bean prices drove the Idaho farm price index down substantially in February, despite the improved livestock prices.

Lumber demand continued strong through the early part of the year. Through February, orders taken by western lumber mills were up 21 percent over a year ago and production was up 17 percent. Lumber inventories, which were relatively low entering the year, have increased and firms appear satisfied with current inventory levels. Lumber exports continue to show large increases over a year ago. A 15 to 25 percent increase in export volume to Europe during the first quarter, plus higher products prices, have put dollar sales well ahead of last year's pace. Lumber exports through the Port of Portland reportedly increased 500 percent while log exports rose 200 percent between January 1986 and January 1987.

Box shipments, which track industrial production, were up 2.6 percent through February over the first two months of 1986, while linerboard production rose 6.6 percent. Domestic demand increased by 6.7 percent, compared with a 5.6 percent increase in export demand.

In Utah, the reopening of the Kennecott Copper facility pushed the mining industry to its first year-to-year employment growth in nearly three years with a 1.2 percent employment increase.

Construction and Real Estate

Most respondents expect that single-family home building will remain strong during 1987, with little change in either direction from from its robust 1986 level. Some express concern that increases in mortgage interest rates could dampen building activity in coming months, but others argue that modest rate increases should not affect housing demand significantly. In areas with weak economies, including Alaska, Idaho, and some rural areas in Utah, California, and eastern Washington and Oregon, the slow pace of building activity is unlikely to pick up unless general economic activity improves.

Virtually all respondents expect slow multifamily residential construction activity due to past overbuilding and high vacancy rates. Consequently, the total number of housing units built in 1987 may fall below its 1986 level in many areas.

Financial Sector

Most surveyed bankers are under increased pressure to raise interest rates due to recent increases in the cost of funds. Some already have raised rates, while others anticipate doing so if the cost of funds stablizes at its current higher level or continues to rise. However, banks in economically hard-pressed areas are reluctant to raise rates, citing demand pressures. While some banks anticipate across-the-board increases in rates, most expect greater increases in business and real estate loan rates. Competition for consumer loans, from financing subsidiaries of auto

companies, should constrain increases in consumer rates for some banks. The squeeze between the high cost of funds and tight demand has reduced margins substantially.