SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICT

December 1987

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SUMMARY*

Most Districts report overall economic expansion with particular strength noted in Boston, Chicago, Minneapolis, and San Francisco. Despite general optimism among surveyed firms, there was also widespread evidence of increased uncertainty about future growth in demand. Furthermore, while the majority of survey respondents said that the stock market crash had not materially altered their capital spending plans, reports of at least some deferrals of plans appeared in a number of District discussions. The manufacturing sector has been a prime source of recent expansion in most Districts. Retail sales are either flat or only slowly growing in most Districts and auto sales are generally sluggish. Construction activity is mixed. Mining is strong across a broad spectrum of extractive industries, but reports of the possibility of future softening in oil and gas drilling expansion were common. The agriculture sector is in a generally favorable condition among the Districts. In the financial markets, some slowing in the growth of loan demand was often cited.

Manufacturing

Manufacturing activity continues to expand. No District reported that a majority of surveyed firms had revised capital spending plans as a result of the stock market crash. Survey respondents generally had positive expectations for the near future. There was clear evidence, however, that the stock market crash had led to increased uncertainty and to a declining degree of optimism about future demands for manufacturers'

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products. St. Louis, San Francisco, and Chicago all cited the declining value of the dollar as a significant factor in generating recent manufacturing growth. Cleveland and Dallas noted increased demands for steel and St. Louis and Dallas mentioned rising demands for electrical equipment and for apparel. Despite the generally positive reports for manufacturing, the Chicago and St. Louis banks both referred to layoffs at auto assembly plants in their Districts and Atlanta reported that appliance and furniture producers are concerned that the stock market plunge may lead to reduced sales.

Consumer Spending

Retail respondents in most Districts report flat or at best slowly growing retail sales. The stock market decline appears to have had little effect, even in areas where the drop was cited as a reason for slower sales growth. The major effect seems to have been on big-ticket items. New York, Cleveland, Richmond and San Francisco each reported weakness in such items, while Kansas City noted markedly lower sales among stores targeting upper income groups. Those Districts reporting on them cited reduced auto sales in October and November, although Philadelphia respondents said sales were above a year earlier. The withdrawal of manufacturers sales incentives was cited as the reason for auto sales declines more often than the stock market drop.

Construction

Construction activity varies considerably among Districts. Chicago reported overall growth, while weakening was noted in the Dallas, Atlanta, and St. Louis Districts and was expected in the Boston District.

The drop in the stock market appears to have had a depressing effect on New York, Richmond, and Chicago homebuying. New York District office space demands remain high despite softening in the downtown Manhattan market, while high vacancy rates linked to past overbuilding have induced Atlanta District office and industrial developers to put projects on hold.

Mining

The strength in the mining sector continues across a broad spectrum of minerals, but several Districts report recent small declines in oil and gas drilling and the possibility of future sluggishness in energy extraction. Atlanta cites recovery in the coal industry. Minneapolis notes that the boom in gold mining continues and copper production is expanding. Dallas, Kansas City and Minneapolis all note that the recovery in drilling is slowing and report concerns that future expansion in drilling may cease.

Agriculture and Forestry

Most reporting Districts note improved prospects for their farm sectors, but several noted that recent dry weather has caused problems. Richmond, St. Louis, Minneapolis and Dallas all report an improved farm income outlook. Richmond and Chicago cite widespread increases in farmland prices, while farmland prices have bottomed out in the Minneapolis District and price movements are mixed in the St. Louis District. Agricultural credit conditions are improved in most reporting Districts. Some Districts cited problems with soybean yields, in part, because of dry weather conditions. Cotton production and livestock prices are generally cited as favorable in Districts that discussed them. In forestry, demand for wood used in paper and pulp is generally up. Lumber demand and prices are down, in part, because of seasonal factors.

Financial Services

Growth in overall loan demand appears to have slowed in a number of Districts. Consumer loans are either growing more slowly or have been unchanged at most reporting District banks, although New York cited strong demand since the stock market crash. Real estate loan expansion was fairly widely noted. Philadelphia and Kansas City reported essentially flat business loan activity, while Atlanta cited stable to increased loan demand and Cleveland noted recent expansions.

FIRST DISTRICT - BOSTON

Most First District manufacturing contacts enjoyed a strong third quarter. A majority report no impact from the decline of the stock market, but some manufacturers have had customers delay orders. Recent retail results have also been mixed. Some retail chains, notably discounters, have seen no fallout from the stock market; these chains continue to register substantial sales increases compared to a year earlier. Others report a noticeable weakness in November to date. There is a near-unanimous expectation among manufacturers and retailers, even those continuing to do well, that customers will be more conservative in coming months as a result of the recent volatility in financial markets.

Retail

Among the merchants contacted, retail sales in October and November ranged from 41 percent ahead of year-earlier figures to 7 percent below. Those experiencing a slowdown could find no change in local conditions to explain it - the slowing was fairly general across product lines and geographic areas. They attribute the weakness to national economic conditions in general and to the stock market decline and rising import prices in particular. Only toys and children's apparel have been doing better than expected.

Inventories are said to be generally satisfactory. Orders are being carefully scrutinized to assure "sufficient but not excessive" Christmas merchandise. The perception is widespread that suppliers have additional merchandise available to fill late orders if business picks up more than expected.

Plans for the future are characterized as "conservative," responding to the uncertainty generated by the stock market's volatility. However, no drastic changes are projected. New England merchants remain moderately optimistic about the Christmas season and 1988. Fourth-quarter sales are expected to exceed last year's, in some cases by a modest amount, in others by as much as 20 percent. A similar growth range is forecast for 1988.

Manufacturing

Third-quarter sales for the fabricated metals and machinery firms contacted were 3 to 25 percent above year-earlier levels, while earnings were up 14 to 27 percent. New orders also increased by double digits from 1986. Among the strongest sources of demand were the food, paper, energy, consumer hardware, and defense industries. Sales were softer for products destined for the oil and gas, auto and some parts of the construction industries.

With respect to the period since the third quarter, one-third of respondents report some fallout from the stock market decline. They generally cite delays rather than cancellations of orders and believe that customers are drawing down inventories in order to avoid commitments. Among the majority of firms that have seen no effects, two capital goods makers caution that their orders tend to lag other economic changes.

First District manufacturers also report little evidence of resurgent inflation. A few respondents mentioned increases in copper, paper, chemicals and trucking costs; however, most said their own prices were steady or falling while a minority reported increases of up to 3 percent.

Employment levels are generally holding steady or are declining through attrition. Firms remain very reluctant to hire, although one large firm plans a major hiring program.

Capital spending is at or, in several cases, well above last year's levels. While most respondents see no reason to change these spending plans, two or three are holding back on discretionary purchases and are considering ways to maintain their flexibility - by leasing rather than buying, for instance.

A majority of First District manufacturers are looking forward to a good 1988 with no adverse impact from the stock market. However, one firm that expects excellent sales growth in 1988 has reduced its forecast for its industry's growth by about one-third. Moreover, a significant minority of First District firms expect a flat fourth quarter and very slow growth in the first half of next year. Even among those expressing confidence, several contacts said they will be watching consumer spending very closely and one tool maker expressed concern about the impact of stock buybacks on its customers' capital spending plans.

<u>Outlook</u>

The New England Economic Project (NEEP), a non-profit organization comprising businesses, government agencies, and educational institutions, held its semi-annual outlook conference in mid-November. The NEEP forecasts for the six New England states, taken together, call for slower employment growth in 1988 than in 1987, primarily attributable to slower growth in the national economy in the aftermath of the stock market decline. In keeping with the national outlook, New England's rate of growth will pick up in 1989. Unemployment in the region will remain at roughly 3-1/2 percent throughout the forecast period. Growth is expected to be more balanced than in recent years, with manufacturing employment increasing modestly in both 1988 and 1989 while rates of growth slow somewhat in nonmanufacturing, especially construction.

SECOND DISTRICT--NEW YORK

Economic activity in the Second District varied among sectors in recent weeks. In most areas general business conditions improved somewhat further, and office leasing was strong. However, conditions in residential construction and retail sales were mixed, and in the wake of the stock market crash, concern has developed regarding the outlook for the New York City economy. Small and mid-sized banks report that demand for consumer installment loans remains strong.

Consumer Spending

The pattern of retail sales in the District has been mixed in recent weeks. While, in general, respondents reported that sales for the month of October were on or above plan, their experience following the mid-month stock market crash varied. Some retailers had an initial falloff in sales--particularly for big ticket items--which was followed by a rebound, while others noted continued weakening since the crash. Still others have thus far seen no effect on their sales. Reflecting this variation in sales, descriptions of inventory levels ranged from "on target" to "4 to 5 percent above plan".

Over-the-year sales gains in October generally ranged from 9 to 13 percent although one retailer reported a much smaller increase at his suburban stores in the District. Soft goods such as apparel and accessories, shoes, and jewelry were mentioned as selling well, but some higher priced items like furniture, furs, and rugs moved slowly.

District retailers are not overly optimistic concerning the upcoming holiday season. Several respondents have adopted a wait-and-see attitude in response to what one termed "the new conservatism among consumers".

Business Activity

Some further improvement occurred in much of the District's economy since the last meeting. However, in the wake of the stock market crash, considerable concern has developed regarding the outlook for the New York City economy where several investment firms have already announced staff reductions. The Rochester survey of purchasing managers reported an increase in the number of firms with improved general business conditions, and no respondents reported a worsening. Also, nearly 90 percent of the survey respondents stated that their company's plans for the future have not been affected by recent events in the stock market. Those reporting that the stock decline has affected plans indicated that it did so because of the effect on their company's ability to raise capital and not because of any change in business conditions. Meanwhile, 85 percent of those surveyed in Buffalo reported better or stable conditions.

Some planned projects, most of them announced since the stock market crash, point to a positive impact on the District's economy. After several months' search, two large banks have chosen Buffalo as the location for their new facilities. Goldome announced that it will buy the former Bethlehem Steel regional headquarters building for use as its new telecommunications center, while Marine Midland will construct a $40 million back-office facility there. In addition, three manufacturing firms also announced plans to expand in the Buffalo area. Groundbreaking ceremonies recently took place in the Syracuse area for the regional distribution center of a package handling company which will provide several hundred new jobs upon completion. Meanwhile, in northern New Jersey, Hudson

County's first shopping mall opened at Newport City, the multibillion dollar residential and commercial development under construction there. Some 2500 jobs are expected to be created at the mall with first preference going to county residents.

Construction and Real Estate

Conditions in the District's residential construction industry remain mixed. In much of the New York metropolitan area the pace is described as slow with few people out looking for new homes and a large inventory of existing homes available. Moreover, in some of these areas where the high prices of homes had already been cited as a major deterrent, the drop in the stock market has reportedly had a further depressing effect on potential homebuyers. Away from the New York metropolitan area, however, homebuilders are still quite active although some slackening is anticipated as the holiday season and winter weather approach.

Office leasing activity continued strong in much of the District though some slowing occurred in the downtown Manhattan market. Analysts attributed this slowdown to employment cutbacks at some brokerage firms and plans announced by others to review their staffing needs. Concern over the additional impact that the stock market crash will have on the securities and financial services industries added to the cautious tone in the downtown market. Expansion in these industries has been a major source of demand for new office space in recent years.

Financial Developments

Senior officers at small and mid-sized banks in the Second District stated that demand for consumer installment loans has remained strong since the stock market crash, and applications for mortgages and home equity loans have not fallen appreciably. One banker noted that the real estate market in her area has weakened since the spring, but she did not see a pronounced reduction in mortgage activity following the crash. Most officers also reported no unusual deposit inflows as a result of the steep decline in the stock market, contrary to the widespread expectation that nervous investors would rush to deposit their funds in federally insured accounts. Most banks in the survey have cut their interest rates in recent weeks, though some bankers voiced doubts that further declines would occur. Because of the steady demand for consumer loans, bankers generally anticipated that the crash would cause only a mild reduction, if any, in their lending activity through the first half of 1988.

THIRD DISTRICT - PHILADELPHIA

The Third District economy was showing signs of moderate expansion in the first half of November. Manufacturing activity was up for the eighth month in a row and factory employment increased for the fifth consecutive month. Retailers reported sales running above last year's pace in October and the first two weeks of November, although the year-to-year increase fell below their expectations. Auto dealers say sales have slipped in the last two months, following a good third quarter. Bankers note slowing growth in business and consumer lending, but say real estate lending, primarily for residential construction, is still strong.

While contacts in the region's business community express concern about the effects of the October stock market drop, they have not altered their expectations significantly. Manufacturers say the outlook is more uncertain than it was before the drop. Nevertheless, they anticipate continued growth, although possibly at a slower pace than in recent months. Area retailers generally agree with the industry consensus that sales in this year's last fiscal quarter will be around 4 percent above the same period last year. They say that if a broad slowdown does develop, they would not expect to see it dampen sales until the spring of 1988. Auto dealers expect to maintain their current rate of sales through the end of the year. Bankers note that growth in business and personal lending has been slowing for several months, and they expect this trend to continue; they do not foresee a sharp drop in loan demand in these categories resulting from recent volatility in the financial markets. Lending officers say demand for real estate loans will remain strong, but that lending for development is growing riskier.

MANUFACTURING

The region's industrial sector posted its eighth consecutive month of expansion in November, according to the Business Outlook Survey. Local manufacturers' overall assessment of current economic conditions indicates continuing moderate growth. Measures of new orders, shipments, and employment moved up in November, while order backlogs were unchanged. Manufacturers of nondurable goods are making gains, on balance, while producers of durable goods are operating at a steady pace.

Industrial prices, both paid and received, are stable for a majority of respondents. Some upward pressure is apparent, however, as it has been for the past few months: from October to November, input costs rose at about 40 percent of the plants polled, and prices for goods sold were up at about 20 percent of the plants.

The stock market's sharp decline in October appears to have prompted some concern for the future among survey respondents. While positive views still edge out pessimistic expectations in the November survey, the overall level of optimism is off from recent months. Also, several survey participants say the uneasiness of the financial markets in late October has increased the uncertainty of their own short-term forecasts of business conditions. Nevertheless, on balance, managers at area firms are planning to go ahead with capital spending plans; 61 percent of the companies polled in November plan to continue current levels of capital spending, and 25 percent plan higher outlays for plant and equipment over the next six months.

RETAIL

Third District retailers contacted in mid-November described sales as running somewhat below plan, but "comfortably above" the rate at this time last year. Stores in the Third District generally have not resorted to unplanned discounting, and results of scheduled promotions have met or exceeded expectations. Most product lines are selling satisfactorily, but some weakness has developed in womens' apparel. Merchants say this may be due to rising prices for imported clothing.

Store executives are cautious in their forecasts of Christmas sales, although regional department stores that have mailed Christmas catalogs to customers say the response so far has been good. Retailers say the industry consensus is that sales will be up about 4 percent from last year, in dollar terms, and they have built up stocks for the holiday season consistent with this estimate. Thus, inventory buildup was moderate even before the stock market decline in October prompted concern about consumer spending.

Auto dealers say their third quarter sales were above those of the same period a year ago, but that sales declined during September and have been running at a slower rate since then. They say manufacturers' incentives for over-stocked models will probably be introduced by all domestic companies by the end of the year.

FINANCE

Total loan volume outstanding at major Third District banks in October was 7 percent higher than in October 1986. Real estate lending has been on a strong upswing since the year began, but growth in other loan categories has been slackening since June. Bankers contacted in mid-November said these trends are continuing. Several described commercial and industrial loan volume as "flat" over the past two months. Lending officers said growth in consumer credit has been slowing regularly for months; none observed sharp or unanticipated declines following the October stock market drop.

Commercial bankers expect business and consumer lending to grow slowly in the months ahead. Lending officers say there is no indication of resurgent growth in business loan demand despite signs of a pickup in manufacturing activity, and most believe consumer credit card lending will continue to grow slowly while other personal loan categories will remain virtually flat. The October turmoil in financial markets is not expected to put any additional drag on lending.

Bankers expect real estate lending to remain strong. They say the region's residential real estate markets are still healthy. However, financing needs of developers--for land acquisition, site development, and model home construction --are rising as demand for more expensive homes increases. As a result, builders' borrowing needs are growing in relation to their capital. Bankers say up-front lending to developers is therefore becoming more risky, and that some banks may begin to limit their exposure in construction lending.

FOURTH DISTRICT - CLEVELAND

Summary

Business activity in the Fourth District appears to be relatively unaffected by the recent stock market decline. Manufacturing remains strong as production, employment, new orders, and prices continue to increase and inventories remain low. Capital spending plans appear unaffected by the stock market decline. The effect of the stock market turmoil on retail sales is uncertain at this point, but many retailers expressed concern about its impact on Christmas sales. Automobile sales are down, but appliance and electronic sales are reported to be about normal for this time of year.

Retail Trade

The stock market turmoil has generated mixed responses from local retailers. Several local automobile dealers said that they are experiencing slower sales in recent weeks. Appliance and electronics retailers have noticed little change. However, some respondents expect a slow Christmas season, particularly in the big-ticket and luxury items, which they attribute to a perceived cautiousness among consumers. After the stock market decline, one retailer revised downward his estimate of Christmas sales from 7 percent to 3.2 percent. Markdowns of many items are already planned and some have been implemented prior to the Christmas shopping season.

Labor Markets

Ohio/s unemployment rate edged up slightly from 5.5 percent in September to 5.8 percent in October. A similar increase occurred for Pennsylvania. In both cases, this modest increase was due primarily to a stronger growth in the labor force than in employment. Unemployment rates in the Lexington area continued to fall as employment grew in textiles and apparel.

In Ohio, employment continued to increase across a broad range of sectors, including manufacturing which has experienced a resurgence in recent months. Over the year, total employment in Ohio rose 2.5 percent, while the number of unemployed decreased 34 percent. Despite the overall improvement in employment, the number of manufacturing workers fell 6,000 over the year to date. Losses were concentrated in durable-goods industries. Modest gains in primary metals, lumber and wood products, food and kindred products, and chemicals were not sufficient to overcome losses in transportation equipment, nonelectrical machinery, and fabricated metal products. Nonmanufacturing employment, on the other hand, increased 3.5 percent, with the largest percentage gains in construction and services.

Earnings of production workers in manufacturing industries in Ohio continued to increase through September, primarily due to increased overtime. Their average workweek of 42.5 hours in September was .2 hours longer than the previous month.

Manufacturing

Purchasing managers reported increases in production, new orders, prices, and employment. While remaining optimistic about the continued expansion in manufacturing activity, many purchasers complained of escalating prices and very poor vendor delivery performance. Inventories of commodities and finished products declined from already low levels and many items, including steel and aluminium products, remained in short supply.

Steel production increased sharply in October, rebounding from earlier declines. Production in the Youngstown and Pittsburgh districts, for example, increased by roughly 25 percent from the previous month. Some respondents commented that this production increase is taxing an already high capacity utilization rate.

The recent stock market decline appears to have had little effect of capital spending plans of area businesses. A supplier of drills, valves and other industrial tools reported that they see no indication that their customers are planning to cutback or reduce expenditures. Plans for large-scale investment projects, such as the relining of a blast furnace in the Youngstown area and the restarting of a mill in western Pennsylvania, appear to be moving along as scheduled.

Housing

House sales in the area do not appear to be adversely affected by the recent stock market decline. Real estate agents report that sales of higher priced homes have improved since October. Some agents expect sales to steadily improve as mortgage rates decline in response to lower stock prices.

Banking

District loan demand has been moderate. Total loans outstanding at large banks rose at an annual rate of 4 percent during October. This lending was down from the pace experienced in August and September, but up compared to loan growth registered during the same period a year ago. Real estate and business lending accounted for nearly all of October's loan growth. Consumer installment lending has been relatively flat with gains in home-equity financing offsetting a slight contraction in traditional consumer installment credit.

FIFTH DISTRICT-RICHMOND

Overview

District economic activity rose in some sectors in November and stayed about even in most others, while optimism about the economic future generally softened. Manufacturers and department stores reported increases in activity. Other retail activity and residential construction were also reported to be generally firm. City bankers reported loan demand to be even with last month, while agricultural bankers were optimistic about financial and income prospects for farmers.

The decline in the stock market has apparently had a significant effect on business expectations, but not on plans for capital spending. Our business and financial contacts are now less optimistic than they were a few weeks ago about prospects for economic growth. Also, a higher percentage now expect inflation to increase. Only a small proportion, however, indicated changes in their capital spending intentions.

Consumer Spending

Most department stores reported that their sales were higher in mid-November than they were in late October and at this time a year ago. In general, store managers expect a good Christmas season.

The combined responses of all kinds of retail establishments indicated that sales have been about flat overall in recent weeks. Several retail executives reported declines in the sale of big ticket items, and nearly half of the respondents reported increases in their inventories. Retail employment was steady.

Most retailers said the stock market decline had had no effect on their business, although a few thought it had reduced consumer demand somewhat. A small number of retail respondents said their firms had decided to postpone some planned fixed investment.

Manufacturing

District manufacturing activity expanded in early November, although at a slower pace than earlier this year. Forty percent of the respondents to our regular mail survey reported increased shipments in November, as compared with 52 percent who reported increases in September. The responses also indicated that new orders and employment grew less rapidly, the workweek increased less, and the backlog of orders was unchanged. Manufacturers reported somewhat higher inventories of materials and finished goods.

The prices of raw materials and finished products continued to rise, according to District manufacturers. A small but higher-than-normal percentage of producers reported experiencing shortages of some materials. Perhaps because of these shortages and rising input prices, two-fifths of manufacturers have raised their estimates of inflation in 1988. Only one-sixth have lowered their estimates.

The fraction of manufacturers expecting growth in their firms in the next six months declined from our previous survey. About one-third now believe their shipments and new orders will rise, compared with about one-half in the previous survey. Most manufacturers indicated that they plan to reduce their inventories of both materials and finished goods in the next six months.

District manufacturers participating in our survey also appear to have become less optimistic in their outlook for the national economy. Thirty-four percent of the respondents now believe the level of general business activity in the nation will decline in the next six months while 24 percent expect it to increase. In our previous survey of manufacturers, these percentages were 18 and 43, respectively.

Capital Spending. Our survey regularly asks manufacturers about their current and expected capital spending. This month we included a second question regarding how the stock market crash had affected their plans.

The distribution of responses to the regular questions showed no change from the two previous surveys. About one-fifth of the manufacturers indicated that they had increased their current capital spending from a month ago, and about three-fourths reported no change. Looking ahead six months, about three of ten producers expect to increase spending, while about two in ten expect to reduce it. It bears repeating that these numbers are virtually identical to those from the previous survey, conducted in late September.

Regarding the second question on the impact of the market crash on spending plans, 80 percent of the respondents indicated that the crash had not affected their plans. However, six percent--all of them producers of durable goods--reported that they had decided to scale back their plans.

Residential Construction

A survey of builders and realtors in the District indicated generally firm demand for single-family homes over the last few weeks. Some firms reported that the October stock market decline decreased customer traffic for a week or two, but others saw no noticeable effect. Most respondents agreed that recent declines in mortgage rates have helped stimulate their business.

Agriculture

A mail survey of District agricultural banks indicated increased optimism about the financial and income prospects for agriculture. Farmland prices were reported to be higher than in the previous quarter, and all respondents expect land prices to be stable or to move higher in the next three months. Respondents said that loan repayment rates had increased, and over two-thirds of the agricultural banks indicated that they were actively seeking new farm loans. Several banks attributed the improved income prospects for farmers to farm price support programs.

Financial

A survey of District financial institutions indicated that the demands for commercial, consumer, and home equity loans have not changed in the last month from previous levels. Opinions about the outlook for the next six months were mixed, with more than half of the bankers expecting increased loan activity.

Looking ahead to economic conditions six months from now, most bankers are optimistic that the trade deficit will be lower. However, they expect slower economic growth, higher inflation, and a higher unemployment rate.

SIXTH DISTRICT - ATLANTA

The Southeast's economy continues to show a mixed performance. Auto sales and residential construction have slowed but tourism, financial services, and most other industries have improved or remained stable. Retail sales declined briefly in late October but have since rebounded. For the most part, capital spending plans have not been altered recently. The prevalent attitude seems to be one of cautious optimism. In this report we have concentrated on developments since the stock market crash in mid-October.

Employment and Industry. Reports on the market's effects on southeastern industries are mixed. Many firms indicate no impact is expected before early next year. There have been a few reports of expansion plans put on hold and initial stock offerings for some companies have been postponed but not cancelled. However, most manufacturers are optimistic and are proceeding with expansion projects.

The region's appliance and furniture producers are concerned that the stock market plunge may result in more conservative spending patterns. Spokesmen for the carpet industry are also uneasy about possible consumer belt tightening and a construction slowdown.

Textile companies are leaner and more competitive than in the past as exports have bolstered the industry. The lower value of the dollar is also stimulating domestic sales by making imports more expensive. There have been no signs of slowing in the paper industry. If lower domestic new car sales and output persist, district tire and auto part producers expect increased replacement goods demand to make up for some of the loss of original equipment business.

Consumer Spending. The plunge in stock prices has elicited mixed reactions from retailers. Sales across most product lines, particularly durables, decreased during the week of the crash but subsequently rebounded. There is some indication that the impact on discount stores was less severe than on full service department stores. Sales ended the month flat or slightly above last October, and early indications for November are moderately favorable.

Expectations for the holiday season were not adjusted significantly after the market's fall since retailers throughout the District had already been expecting only slight increases over last year's sales. Promotional activity will be increased compared to last year, but most retailers report they are not at this point giving price discounts. They also have not altered their hiring plans for the holiday season.

Auto sales in October and early November slowed according to dealers but they believe the behavior had more to do with the removal of factory incentives than the plunge in stock prices. Despite concern over weakened consumer confidence, dealers' plans remain largely unchanged.

Construction. Most contacts reported downturns in overall residential construction which they attribute to seasonal factors as well as economic uncertainty. Birmingham sources noted a small uptick in sales of existing homes in late October, but no change occurred in Mobile. Florida contacts report mixed trends in the state's housing markets. Mississippi and Tennessee sources indicate general slowing in sales activity in larger cities. Multi-family markets have been gloomy throughout the year in the Sixth District, and there is an inventory overhang.

Metropolitan office vacancy rates during 1987's third quarter remained steady but high ranging from 18 percent to almost 30 percent. Only Jacksonville showed significant improvement in absorption, as vacancy rates decreased by more than eleven percent since last quarter. Office and industrial developers in the region report a number of projects are on hold, reflecting earlier overbuilding. Meanwhile retail construction has sustained its strength throughout the region as mall construction flourishes.

Financial Services. Banks and thrift institutions report mixed experiences in recent weeks. While small net increases in deposits have occurred, loan growth has slowed at large commercial banks. Some banks in Georgia, Alabama, and Tennessee note a drop off in loan volume while most Florida, Mississippi, and Louisiana banks report no changes. The rate of growth in consumer loans slipped in October while business and real estate loans have remained stable or increased.

Tourism. District travel agents report no appreciable changes in advance bookings and cancellations in recent weeks. The dollar's decline, however, has spurred a shift away from foreign vacations. Officials expect slight increases in tourism activity throughout the District this winter spurred mainly by convention business.

Mining and Agriculture. Estimated yields of late-harvested crops such as soybeans are lower as a result of dry weather. Damaged pastures are causing farmers to purchase feed for their animals.

Spokesmen in the pulpwood industry report a thriving industry. There is some indication of slight capacity expansion but caution prevails. The lumber industry is experiencing a seasonal softening in markets and slight price declines.

District crude oil production fell in October to a level almost 10 percent lower than the peak in early 1986. Production capacity has declined with the cutbacks in exploration since the early 1980s and with the closing of numerous inefficient stripper type wells. On the other hand, drilling activity increased, reaching its highest point since March of 1986.

District coal production rose modestly in October making the third consecutive month of higher output, supplying evidence of a beginning recovery in the coal industry.

SEVENTH DISTRICT--CHICAGO

Summary. Business activity continues to expand in the District with few signs of significant effects on aggregate activity from the stock market crash. Employment has been trending upward. Apart from autos, industrial activity generally is rising. Nonauto consumer spending appears to be holding up well, overall, though reports are mixed. Capital spending is expanding in a number of industries. Sales of basic industrial supplies have strengthened. Machine tool orders have picked up recently. Lead times have lengthened considerably, and prices of industrial materials and intermediate products continued to press upward after the stock market crash. Building contracts in District states have risen this year, in contrast with a decline in the nation. District farmland values rose for the third consecutive quarter in the July-September period.

Effects of the Stock Price Drop. Reports from District contacts indicate that effects of the stock price drop, so far, are limited. Some retailers saw a slowdown in sales beginning October 19, but only for a couple of days. A few real estate transactions were cancelled shortly after October 19, and inquiries about selling homes rose from some worried participants in Chicago's financial exchanges (though few appear to have listed their homes as a result). The possibility was noted by our sources that sizable cuts in consumer or capital spending could still take place, leading to inventory adjustments and a more general slowing of activity, but they see no evidence that this is occurring. A contact at a large retailer, who has seen no sustained adverse effects on the firm's sales, suggests that, contrary to the recent trend to lower forecasts, projections for activity should be raised in view of the fall in interest rates and the dollar since October 19, and ample liquidity.

Purchasing Managers. Chicago-area purchasing managers reported that orders, backlogs, and production continued strong in October. Vendor delivery times lengthened, and price increases were widespread. Milwaukee purchasing managers indicated that lead times have lengthened considerably, resulting in a slower rate of rise in production and drawdowns of inventories of some materials. Orders and backlogs continue to increase. The lower dollar has sharply boosted exports. Buyers are concerned about the threat of higher inflation at the finished goods level from continued increases in prices of basic industrial inputs "across the board." Firms are still cautious about capital spending commitments.

Capital Spending. One source describes metals producers as on a "capital spending spree" for process improvement. Their more efficient plants are operating at or near capacity. Glass and paper makers are also investing in new equipment, and some cement makers are building new plants. Japanese motor vehicle and parts manufacturers are investing in numerous plants in the U.S., and additional spending is thought likely due to the dollar's further fall over the past month. There are no signs that the fall in stock prices is leading to delays or cutbacks in capital spending projects already underway.

Construction and Real Estate. Residential real estate sales are slow, and few loan applications are "in the pipeline." Rates quoted in the Chicago area for 30-year fixed-rate home mortgage loans have fallen from around 12 percent a month ago to 10.5 percent, with a few lenders at 10.25 percent. Loan applications are typically low at this time of year, but may also be held down in part by hopes that rates will fall further or by households' responses to the drop in stock prices. In contrast, a commercial mortgage banker reports that applications increased following the recent drop in mortgage interest rates; lower rates are viewed as a window of opportunity for refinancings and new projects. Residential construction contracts (in square feet of floor space) in the first nine months of 1987 were up 8 percent from last year in District states, compared to down 8 percent in the nation. Year-to-date mobile home production in District states (mainly Indiana) was 2 percent above last year, in contrast with 5 percent lower for the U.S. Contracts for nonresidential buildings were 14 percent higher in the District and flat in the U.S. A large Chicago-area supplier of ready-mix concrete expects shipments in 1988 to be at a good level but less than this year, mainly reflecting cuts in office buildings and other commercial structures. Numerous projects are in the planning stage. Public works and highway construction will be strong in 1988.

Motor Vehicles. Slow car sales are leading to further production cuts. Three Michigan assembly plants will be shutdown for 1-3 weeks in January with two of these plants then reopening at reduced line speeds. In part, the auto production cuts reflect the shift in consumer preferences toward small trucks, including vans, and the continued strength of imported cars--both truck and imported car sales in October were highest ever for the month. Sources in Michigan remain concerned that announced auto production plans are too optimistic and that further cuts will be needed, adversely affecting suppliers and communities in that area.

Other Manufacturing. A diversified maker of consumer and industrial products reported that sales remained strong in October, with no weakening in any of its lines. Steel production at Chicago and Detroit area mills has continued to rise in recent weeks. Demand is relatively strong for gypsum board and cement in District states. Gypsum board pricing may have stabilized after a drop earlier this year.

Consumer Spending. Recent cool weather has boosted sales of apparel. In the view of one retailer, the outlook is favorable for Christmas. Inventories of nonauto consumer durables and many nondurables are low and unlikely to pose problems for merchants. However, sharp increases in prices on imported women's apparel have led to cuts in consumer spending and extra promotional efforts by retailers to sell excess inventories.

Agriculture. Our latest survey of agricultural banks indicated that District farmland values, on average, rose more than 3 percent in the third quarter, the third consecutive quarterly rise since the downtrend ended in late 1986. Among District states, the third quarter trend in farmland values ranged from no change in Michigan to a rise of nearly 5.5 percent in Iowa. A large proportion of the surveyed bankers noted that demand to acquire farmland is up from a year ago, both among farmers and nonfarmer investors. However, there has been no apparent pickup in foreign investor interest in U.S. farmland.

EIGHTH DISTRICT - ST. LOUIS

Summary

The District's economy improved slightly in the most recent period. Employment growth, particularly in the manufacturing sector, and an agricultural turnaround are positive developments. Slowing construction, flat retail sales and declining consumer loan demand remain weak points in the economy. There is no evidence yet that the stock market volatility has had a major effect on economic activity.

Employment

District unemployment rates edged downward in the third quarter, with few reports of shortages in skilled trades. A shortage of skilled construction workers in the St. Louis area eased this year as a number of large projects were completed.

Regional nonfarm employment grew at a 2.2 percent annual rate in the third quarter, matching the national rate. While employment in most District sectors grew more slowly than the national average, the financial, government and manufacturing sectors grew more rapidly. District manufacturing employment grew at a strong 4.2 percent pace in the third quarter with gains concentrated in industries sensitive to foreign competition, particularly textiles and apparel, electrical equipment and transportation equipment. Several thousand auto workers began a layoff of indefinite length in late November.