

SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS  
BY FEDERAL RESERVE DISTRICT

May 1989

## TABLE OF CONTENTS

|                                       |        |
|---------------------------------------|--------|
| SUMMARY .....                         | i      |
| First District--Boston .....          | I-1    |
| Second District--New York .....       | II-1   |
| Third District--Philadelphia .....    | III-1  |
| Fourth District--Cleveland .....      | IV-1   |
| Fifth District--Richmond .....        | V-1    |
| Sixth District--Atlanta .....         | VI-1   |
| Seventh District--Chicago .....       | VII-1  |
| Eighth District--St. Louis .....      | VIII-1 |
| Ninth District--Minneapolis .....     | IX-1   |
| Tenth District--Kansas City .....     | X-1    |
| Eleventh District--Dallas .....       | XI-1   |
| Twelfth District--San Francisco ..... | XII-1  |

## SUMMARY\*

The nation's economy grew at a moderate, sustainable pace in February, March, and early April. Business activity was relatively strong in the Midwest and South. Consumer spending in most of the country was moderately strong, but signs of slowing were apparent in the Northeast and West. Manufacturing activity expanded at a fairly strong pace throughout the country, and manufacturers are generally optimistic about sales prospects for the rest of the year. The backlog of new orders has been mixed, but no significant changes were found. No serious bottlenecks were reported. Despite the continued strength in manufacturing output, none of the districts report significant increases in input prices or labor costs. Residential construction was mixed, but nonresidential construction levels were described as moderately strong. Much of the winter wheat crop was lost due to dry weather early this spring. Recent rains, however, have improved the outlook for the spring wheat crop, as well as for agriculture in general. Favorable conditions were apparent in the mining and lumber industries.

Consumer Spending

Consumer spending slowed significantly in several districts but grew fairly strongly in others. Boston, New York, Philadelphia, Richmond, and San Francisco report sluggish retail sales. The sales slowdown was particularly marked in consumer durables. Lower-than-expected automobile sales were reported by Richmond, Minneapolis, Kansas City, and San Francisco. A large dealer in the Minneapolis-St. Paul area describes the slowdown in car sales as the worst in over twenty years. Boston reports that retailers are curtailing

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their capital spending programs due to disappointing sales growth, focusing spending instead on upgrading distribution systems rather than on new construction. Several districts point out that the early Easter this year made sales comparisons with last year difficult.

Consumer spending on general merchandise is described as fairly strong by Cleveland, Chicago, St. Louis, Minneapolis, Kansas City, and Dallas. These reports suggest that the economic expansion has been stronger lately in the South and Midwest than elsewhere in the country. Several of these districts also report an early-April recovery in auto sales, partly attributable to enhanced incentives for buyers.

Inventories were at acceptable levels in all districts. The rate of retail price increases is largely reported as being fairly moderate. Boston and Minneapolis point to an increase in wholesale prices of goods purchased by retailers. Retail prices, however, have not risen much, and Boston reports concern about eroding retail margins.

### Manufacturing

Manufacturing activity continued to expand at a fairly strong pace. None of the districts report declines in shipments; most report significant increases. St. Louis reports that manufacturing employment rose by an impressive 10.8 percent from December to February. Cleveland reports that cold-rolled and galvanized steel operations were at full capacity. Chicago reports that shipments of major home appliances reached record levels.

Manufacturers are generally optimistic about sales prospects for the year. San Francisco reports strong demand for commercial aircraft; Atlanta reports significant increases in capacity in the broiler-chicken producing and processing industry; and Chicago cites brisk demand for equipment installed in construction projects. Reports are mixed on the backlog of new orders.

Boston and Atlanta report some weakness in new orders, but Philadelphia, Cleveland, Richmond, and Chicago note that new orders increased in many industries.

Capacity utilization was generally at satisfactory levels: no serious bottlenecks were mentioned. Atlanta reports that capacity constraints are easing in several sectors. In contrast, reports on capital spending plans are somewhat mixed. Boston reports that half the manufacturers they surveyed plan to increase capital spending, but a third plan to invest practically nothing. New York reports plans for a \$70 million business park in the Rochester area. Dallas reports that electronics manufacturers are planning significant increases in investment spending. Atlanta, however, reports that capital investment appeared to be slowing.

None of the districts mention significant increases in input prices or labor costs. Boston reports that most of their survey respondents were not alarmed by steady to slightly higher input prices. Philadelphia reports that higher prices were not quite as widespread as they were over the winter. Chicago also reports that prices paid by manufacturers showed increases, but less so than earlier. Respondents to a survey by Kansas City indicate that input prices are expected to stabilize or decrease in the near future.

### Construction

Housing construction reports are mixed. New York reports that a glut of houses in the metropolitan areas of New York City and New Jersey is deterring homebuilding in the area, but homebuilders in upstate New York are quite active. Residential construction was vigorous in the Chicago area, but first-quarter housing permits in St. Louis were down 31.8 percent from a year earlier. Minneapolis and Kansas City report declines in residential construction, but Dallas reports that single-family housing permits were above last

year's levels. San Francisco reports that construction activity was strong, though limited by a lack of available land.

Nonresidential construction is generally described as moderately strong. New York reports that office-leasing activity has been brisk. Chicago reports that district contracts for nonresidential buildings were at their peak last year, and Dallas reports that nonresidential building activity showed year-over-year gains in contract values.

### Employment

Conditions in the labor market are described as largely satisfactory. Unemployment rates are generally low. Boston reports that the region's labor markets seemed less tight. New York reports that the unemployment rate there dropped sharply, primarily because of a decline in the number of job seekers. Atlanta reports that wage increases remained mostly in the 3 to 5 percent range, which is not regarded as too high. However, Atlanta also notes shortages of skilled workers in many sectors. St. Louis reports that payroll employment from December through February grew at a relatively high 6.3 percent annual rate.

### Agriculture and Resource-Related Industries

Soil moisture conditions have improved somewhat in several regions after last year's drought. Rains in March and April eased the stresses of the drought in California, parts of Missouri, and North Dakota. Chicago reports that soil moisture conditions were adequate for the start of the growing season in most of the district except western Illinois and much of Iowa. However, the recent rains came too late for much of the winter wheat crop. Wheat yields are expected to be below normal in Kansas and parts of Oklahoma due to dry conditions throughout the early spring. According to Dallas, the

winter wheat crop was damaged by insufficient moisture and by insects. Production of fresh vegetables is reported to be recovering from the effects of a February freeze in parts of the South and Southeast.

Oil prices have risen sharply in the aftermath of the Alaskan oil spill. The spill is temporarily helping the Alaskan economy, though not the ecology: fishermen are being paid \$2,500 per day for use of their boats for cleanup activities. Oil and gas drilling activity reports are mixed but show some recent signs of strength. Dallas reports that the rotary rig count in the district was up sharply in March. Kansas City reports a decline in drilling rigs from February to March but a rebound in April.

The lumber industry appears to be doing very well. Minneapolis and San Francisco report that the main problem is a shortage of available logs. Minneapolis also reports that environmental concerns have delayed logging activity. Reports on capital expenditure plans in this sector are mixed, with Minneapolis reporting substantial expansion in capacity but San Francisco reporting that lumber shortages have caused mills to reduce expenditure plans.

FIRST DISTRICT-BOSTON

Business took on a softer tone during March and the first half of April, according to First District reports. Retail sales were generally below plan, and most manufacturers report moderate growth in sales but weak new orders. Price pressures are receding, and many contacts noted that the region's labor markets seem less tight.

Retail

New England retailers report goods moving slowly and below plan in March and early April. The slowdown is broad-based, covering both up-scale and discount chains, hard goods and soft. Sales of building materials have come down considerably from a strong 1988. Auto dealers report similar experiences. However, several respondents detect a very recent upturn and spending has held up in northern New England. Inventories have not become a problem, although some retailers are relying on a rise in spending later this spring to reduce stocks.

Wholesale prices are generally rising at the same rate as last year, while the rise in retail prices has slowed; thus, gross margins have eroded somewhat. Several respondents also report recent softening in the labor market. Although increases in medical insurance premiums trouble some merchants, wage pressures are generally receding.

Several contacts are involved in corporate restructuring that has led to reorganization, automation of office and distribution facilities,

and cuts in managerial staff. The resulting increases in operating efficiency are helping these firms adjust to the pressure on gross margins.

Most retailers' capital spending plans for 1989 were already below last year's levels. In response to disappointing sales growth and rising interest rates, several are now further curtailing their capital programs. Spending is focused on remodeling and upgrading office and distribution systems, not new construction.

Retailers generally expect growth in 1989 to be less than last year. Some remain hopeful that sales growth will return to its former pace in the traditionally strong fourth quarter. Merchants in the still-vigorous northern states are more optimistic, but building suppliers expect a cyclically down year.

#### Manufacturing

Reports from First District manufacturers suggest that shipments remain moderately strong while new orders are less robust. For most contacts, sales are up 5 to 8 percent from year ago levels, but one-third report that shipments are flat or down. Looking to the future, most respondents report new orders are flat to down while the rest have year-to-year gains of as much as 5 percent. Several firms mentioned that customers are delaying orders or, more often, payments. Firms serving auto, appliance and computer makers, contractors and restaurants report relatively weak demand. Despite current signs of softness, all manufacturing contacts are keeping inventories in line with targets.

Manufacturers also express less concern about materials prices than in recent months. Most find input prices steady to up slightly -

"nothing alarming." Only two firms mentioned that metals prices are still climbing. One-third of the respondents have raised their own prices by 4 to 15 percent during 1989. While most of the others have not changed their sales prices in the last six months, computer-related prices continue to fall.

Some respondents sense that New England's tight labor markets are loosening up, but others disagree. Employment levels are generally unchanged. However, some contacts are hiring sales staff (available) and software engineers (harder to find). Two others are reducing employment through layoffs or attrition. A "low tech" firm reports attracting more applicants per job opening and getting good programmers and analysts laid-off by high-tech firms. Almost no one sees wage pressures building, but several complained of rising medical and insurance costs.

Capital spending plans are mixed - with roughly half of the manufacturers planning to increase expenditures from last year's levels, but one-third investing practically nothing. The rest expect expenditures to remain even or decline. The focus of this spending is maintenance, cost reduction and the introduction of new products, not buildings. Indeed, several firms mentioned leasing as the preferred way to acquire additional space.

Among First District manufacturers, respondents are divided about the prospects for a recession in 1989. Half expect a modest recession; the others do not foresee a downturn but anticipate slow growth in the second half.

## SECOND DISTRICT--NEW YORK

The pattern of developments in the Second District economy was mixed since the last report. Unemployment rates fell sharply in New Jersey and New York during March, though primarily as a result of fewer job seekers, and office leasing activity continued at a moderately rapid pace. In contrast, however, demand for new housing varied considerably over the District and consumer spending was generally slow in March. Most small and mid-sized banks reported that demand for home mortgages is approximately unchanged from what it was last spring.

Consumer Spending

District retail sales were sluggish during March. Several respondents reported over-the-year declines despite the fact that Easter occurred in March this year instead of April as in 1988. As a result, sales fell well below targeted levels at most stores contacted. Only one chain of department stores reported that sales were "right on plan." While some retailers attributed the disappointing March results to "un-spring" like weather, others were at a loss for explanations. Year-to-year changes in March ranged from -6.0 percent to +3.2 percent with sluggishness noted in many categories. One category in which sales generally remained good was women's apparel, a slow seller throughout 1988.

In spite of the lackluster sales results, most respondents reported that inventories were at satisfactory levels, due in part to large markdowns on some items. Based on one week's results, April is showing a better tone than March and respondents were hopeful that this would continue.

### Business Activity

Unemployment rates in New York and New Jersey fell by almost one percentage point in March as New Jersey's rate hit a record low. The improvement was primarily the result of fewer persons seeking work rather than a marked increase in employment and may not be sustainable in the months ahead. On Long Island, for example, the local economy is braced for the continuing impact of the Navy's cancellation last December of an attack bomber contract. A loss of several thousand more jobs is expected at the aircraft company and its suppliers by year-end. In addition, the recent announcement by a major New York City securities firm that it plans a substantial restructuring which could result in the layoff of a couple of thousand employees is also a source of concern. The brokerage industry is still feeling the effects of the October 1987 stock market crash and a slowdown in retail activity since that time.

Eighty-four percent of purchasing managers in Rochester and 75 percent in Buffalo reported stable to improved general business conditions in March, virtually unchanged from the February numbers. In both cities more than half the surveyed firms reported higher prices on the commodities they purchased.

Few new investment projects were announced in recent weeks. Among the largest of these was a \$70 million business park in the Rochester area which Eastman Kodak and Pioneer Development Corporation hope to begin constructing this year. The park would include office buildings, shops, restaurants and hotels to be built on vacant land owned by Kodak.

### Residential Construction and Real Estate

Demand for new housing in the District has been mixed in recent weeks. A glut of homes in the resale market was cited as a major deterrent to homebuilding activity in the New York metropolitan area and northern New Jersey. Existing homes prices have begun to come down somewhat, but many observers believe still lower

prices are needed before current owners can sell and "move up" to new homes. In sharp contrast, homebuilders in several upstate New York communities are quite active and home prices are rising in response to strong demand.

Office leasing activity has been at a moderately strong pace since the last report, with vacancy rates showing little or no change. Upward pressure on vacancy rates in Manhattan is expected to build, however, with the completion of many new commercial buildings now under construction and an increased supply of existing office space as these new buildings become occupied. Elsewhere in the District, the volume of new construction in northern New Jersey and Fairfield County has slowed somewhat and some observers believe this represents a turning point in the prolonged and rapid expansion of those suburban areas.

#### Financial Developments

Senior officers of most small and mid-sized banks in the Second District survey reported that demand for home mortgages is approximately the same as last spring. Responses were mixed regarding the strength of the bankers' local residential real estate market. About half described their local real estate market as active, while half, particularly those in the New York City metropolitan area, characterized it as soft. Most of the respondents have noticed that homebuyers are currently showing greater interest in fixed-rate loans, possibly because the rise in interest rates from a year ago has been less for fixed-rate loans than for adjustable-rate mortgages. Others speculated that buyers have become more favorable toward fixed-rate mortgages because of uncertainty about the future course of interest rates. Moreover, despite aggressive marketing of home mortgages at some of the banks, few were offering concessionary, or so-called "teaser", first-year rates on adjustable-rate loans. Though some surveyed bankers believe rates will remain stable, most expect rates will decline somewhat over the next six months.

## THIRD DISTRICT - PHILADELPHIA

Reports from most sectors of the Third District economy in mid-April suggest little growth overall in the past two months. Manufacturers in general indicate that business has been just steady, although nondurable goods producers note a pickup in April. Retailers report only slight year-over-year gains in total sales for March and April, and an actual decline in sales of big-ticket items in recent weeks. Auto dealers say sales slipped in March and continue to run below the annual selling rate achieved earlier in the year. Bankers generally report that overall loan growth continues at a healthy pace, but several major banks note some easing in the rate at which they are adding to the volume of commercial and industrial loans outstanding. Deposit growth continues to run below targeted rates at many banks, but none indicate that they are restricting asset growth due to funding constraints. Several banks have gained new funds with promotions of 18-to-24-month certificates of deposit.

Looking ahead, Third District business contacts see only slight improvement, at best. Manufacturers expect only steady business over the next six months. Retailers expect dollar sales for the spring and summer to run even with or just marginally above the same period last year, and auto dealers anticipate unit sales for all of 1989 to fall as much as 10 percent below last year. Bankers expect overall loan growth to stay close to its current pace, but they anticipate some slackening in the expansion of commercial and industrial lending in the second half of the year.

MANUFACTURING

Activity in the Third District industrial sector appears to be easing to a steady pace. Just over half of the manufacturers contacted in late March and

early April reported that business was stable, and the number noting improvement barely exceeded the number indicating that their business was slowing. Reports of improvement were common among nondurable goods producers while most makers of durables said business has been flat in recent weeks.

Overall, executives at area industrial firms generally noted modest increases in new orders and a fractional rise in shipments but no change in order backlogs during March. On balance, area firms are permitting inventories to run down for the fourth month in a row. Employment is holding up as area manufacturing firms added marginally to payrolls during March.

Industrial prices in the region continue to rise. Nearly half of the manufacturers contacted in April said input costs moved up from a month earlier and one-quarter raised the prices of the products they make. The increases do not appear to be accelerating, however, as reports of higher prices are not quite as widespread now as they were over the winter. Nevertheless, local manufacturers generally expect continued upward price pressure.

Looking ahead, local manufacturers see virtually steady conditions over the next six months. About a third of those polled in April expect improvement while nearly as many anticipate slower business between now and October. On balance, managers at area plants foresee modest growth in new orders and shipments, but they expect order backlogs to remain steady and they plan to work inventories down further from current levels. On the employment front, industrial firms in the region plan to maintain payrolls at current levels, but they may make some reductions in the workweek during the spring and summer. On balance, local firms continue to schedule hikes in capital spending, although there are increasing reports of projects being postponed, especially in heavy industries.

RETAIL

Third District retailers contacted in mid-April generally indicated that sales for March and early April were only slightly above sales for the same period last year, on a current dollar basis. While some stores, particularly those selling upscale goods, reported satisfactory year-over-year growth, many merchants describe the current situation as "difficult." Several retailers noted that sales of big-ticket items have edged down recently.

Store officials expect dollar sales for the balance of the spring and summer to run about even with or marginally above the year-ago pace, but they are concerned that consumers could grow cautious in the months immediately ahead if economic news is not good.

Labor costs are still considered a problem by Third District merchants as the pool of qualified job applicants, especially in suburban areas, remains well below retailers' needs. Several large discount chains have announced plans to enter the region, and local merchants expect the competition for workers to be as intense as the competition for customers.

Third District auto dealers report that sales slipped in March and remain below the annual selling rate recorded earlier this year. Import dealers have suffered a worse decline than domestic dealers have, but the domestic dealers note that sales of light trucks, which had been strong for the past few years, have fallen off recently. Despite the introduction of rebates and incentive financing by the manufacturers, area dealers expect unit sales for this year to be as much as 10 percent below last year's level.

FINANCE

Total loan volume outstanding at major Third District banks at the end of March was 13 percent above March 1988, marking a year of steady growth. Real estate lending remains the fastest growing major loan category. Commercial and

industrial lending is growing at a healthy rate, according to bankers contacted in mid-April, although they note some slowing from the growth rate recorded in the first quarter. Consumer lending is expanding but at a slower pace than other loan categories, and bankers believe growth may ease further.

Total deposits at large Third District banks at the end of March were 8 percent above the March 1988 level, with demand deposits virtually unchanged from a year ago and other checkable deposits up about 5 percent. Bankers report that growth in the volume of money market deposit accounts has eased substantially since January while time deposits continue to expand at a good pace. Several banks are promoting certificates of deposit with maturities up to two years, and they are obtaining significant amounts of new funds at less than 50 basis points above the federal funds rate.

## FOURTH DISTRICT - CLEVELAND

The economy shows some mixed signs of slowing, led by consumer spending and residential construction. The worst of the surge in food and energy prices is probably over, assuming improved supplies. Higher interest rates are generally not considered to have had much effect on housing and other construction, or on capital goods industries. Thrifts continue to experience deposit outflows, although the April outflow apparently was not as severe as in previous months this year.

Consumer Spending. Several retailers report sales were better-than-expected over the past 6 weeks, and better than what has been reported in national data. Some retailers expect sales to soften this quarter, especially because of higher gasoline prices. An upscale retailer, however, noted a double-digit increase in spending last quarter and believes his upper-income customers are not much affected by a rise in interest rates.

The automotive industry apparently is successfully offsetting higher interest rates by offering special financing rates and cash rebates that are the broadest and, in some cases, the most generous yet offered. Incentives are not as broad for foreign cars. Auto dealers report strengthening sales in early April. They generally are guardedly optimistic over spring and summer sales but are more cautious than dealers surveyed in early March. Dealers and consumers appear concerned over the course of the economy and interest rates, and dealers are cautious in placing orders that may add to their inventory. Moreover, liberalized lending terms have been attracting higher credit-risk buyers.

Construction. Interest rate effects on construction activity appear to be marginal. Some realtors report sales of existing houses fell in April for the second successive month, which some attribute to sizable price increases over the past year. Two nonresidential builders acknowledged that interest rates may be having a dampening effect on construction but assert that is a relatively small factor in investment decisions. Respondents report no shortages of labor or supplies, except for engineers and some construction steels.

Capital Goods. Producers of durable goods remain optimistic about sales prospects for 1989 and report no apparent effects from higher interest rates. Metal cutting tool orders slid in January and February but rebounded since then; orders for the year are still expected to at least match those of 1988. Orders for industrial controls also rebounded in March following softness in late 1988, and lead times have been reduced because of an improved supply of computer chips. A semiconductor and electronics supplier also reported a rebound in their orders since last February, which they believe is consistent with their forecast of record sales again this year. In general, capital goods producers report capacity is still available, and they expect selective price increases to restore eroded profit margins.

Steel operations are still at full capacity for cold-rolled and galvanized sheets, but producers report capacity is available for some other types of steel products. Some producers also note recent softening for bar products (for machinery and automotive industries) and structural steels (for buildings).

Inflation. Food prices are expected to moderate by summer, following the first-quarter surge. Prices are expected to increase 4% to 4 1/2% in 1989,

although beef prices may rise by late summer, according to a national food chain. A food processor reports a substantial increase in corn sweetener costs since late 1988 because of the drought, but they expect prices to ease by late summer. Packaging costs, however, have been increasing recently because of higher energy costs. Food industry respondents report no buyer resistance to the jump in food prices.

Gasoline prices are probably close to a peak, barring additional supply constraints, and crude oil prices will probably be under downward pressure over the next few months as additional supplies become available. The Alaska pipeline is already back to capacity, although deliveries are still limited.

Financial Institutions. Net deposit outflows continued in April, but were not as severe as earlier in the year. Some of the larger thrifts are deliberately reducing their brokered deposits. A few thrifts that experienced large inflows in March will apparently show either a small inflow or small outflow in April because they have become less competitive on rates. A small well-capitalized thrift reports that deposits rose in April because they were able to sell their CDs in other parts of the country where interest rates are lower than in local markets. Most thrifts report little consumer resistance to higher interest rates, but mortgage loans have softened probably because prices of new and existing homes have risen rapidly relative to incomes over the past year.

Banks report a softening in consumer installment and mortgage loans in recent weeks, and a reduced volume of commercial and industrial loans.

## FIFTH DISTRICT-RICHMOND

Overview

Signs of slower growth in the District economy were apparent during the first half of April. Retail sales were weaker, especially auto sales. Manufacturing activity expanded in late March and early April, but less than in February, while the prices of raw materials continued to rise. Export activity at District seaports was higher, but import activity was mixed. Both residential and non-residential building were weaker. In agriculture, persistent rainfall has kept farmers out of their fields, delaying normal spring planting. Among financial institutions, higher interest rates appear to have encouraged more savings, while the impact of these higher rates on loan activity has been mixed.

Consumer Spending

District retail activity slowed during the first half of April according to our regular mail survey. About 40 percent of the respondents said their sales decreased while less than one-third reported increases. The proportion of respondents indicating lower sales was slightly greater than in February. Department stores reported that sales were generally flat except for somewhat stronger sales of big ticket items. Almost three-fourths of the car dealers surveyed indicated lower sales. Most retailers expect their sales to increase in the next six months.

Manufacturing

District manufacturing activity grew at a moderate rate in late March and early April, although the pace of growth was somewhat slower than in February. Smaller proportions of our regular survey respondents reported

increases in shipments, new orders, backlogs of orders, and employment than in February, though reports of increases still outnumbered decreases. Respondents indicating declines in the length of their workweek, however, slightly outnumbered those reporting increases. Growth in new export orders was reported to have slowed since February.

Manufacturers reported that the prices of both finished products and raw materials continued to rise in recent weeks at about the same rate as in February. A number of respondents indicated their profits would suffer because they were afraid to pass along the increases in raw materials prices.

District manufacturers remain optimistic about prospects for continued economic growth in the nation and for their businesses in the next six months, although their optimism has diminished somewhat from our February survey. In the current month's survey, as in the previous one, the number of respondents expecting increases in shipments and new orders exceeded the number expecting declines. In a reversal of the results of our February survey, however, the majority of respondents to our current survey now expect backlogs of orders, employment, and the length of the workweek to decline in the next six months.

### Ports

Reports received from the three major District ports--Hampton Roads (Norfolk), Charleston, and Baltimore--showed increased export shipments so far in April compared to the same period in March. The import picture was mixed with shipments reported to be about the same at Charleston and Baltimore but slightly lower at Hampton Roads. All ports indicated that, compared to a year ago, export activity was outpacing that of imports, and

port representatives expect this trend to continue during the next six months.

#### Financial

A telephone survey of Fifth District bankers indicated that the demand for consumer credit grew slightly in the first half of April. Demand for home equity loans continued strong, while the demand for auto loans was reported as mixed. Most of those contacted reported that their commercial loan activity was either unchanged or slightly higher. Nearly all respondents reported increases in consumers' savings, which several attributed to higher interest rates. Over sixty percent of the respondents said they have seen no signs of a slowdown in their local economies.

#### Agriculture

District farmers intend to plant about 10 to 12 percent more acres of corn, soybeans, and barley this year, but recent rainfall has saturated fields in much of the District, delaying planting activity. Only about five percent of the corn acreage is in the ground, compared to 18 to 20 percent considered normal for mid-April. If fields do not dry soon, some farmers may not be able to get corn planted in time and may wait until June and plant soybeans instead.

A late freeze killed a large number of fruit blossoms in Virginia and the Carolinas, but yields are not expected to be reduced appreciably.

## SIXTH DISTRICT - ATLANTA

Overview: Firms headquartered in the Southeast report that business activity continues to move ahead at a moderately healthy pace. Some shortages of both skilled and unskilled workers are reported by firms in both the manufacturing and service sectors. Most contacts, however, say that sufficient labor is available and continue to report that wage rates are rising at a 3-5 percent range. Increases in prices of materials and final products are showing some acceleration, particularly where imported goods are a significant component. At the same time, order backlogs appear to be easing a bit and vendor delays as well as inventories are said to be generally acceptable relative to sales. Capital spending plans of businesses, although decelerating, remain stronger than a year ago; there are still more reports of spending for modernization rather than for outright expansion. Loan growth is weakening in both the consumer and real estate categories. Delinquencies are not a major problem but real estate lenders express concern about housing and commercial properties in overbuilt areas.

Labor Markets: Wage increases remain mostly in the 3-5 percent range although there are a few notable exceptions. One manufacturer reports wage hikes in the 10 to 15 percent range for low skilled workers in certain fields; the wage increase is estimated to be less costly than the turnover that would occur without it. Welders, pipe fitters, machinists, engineers, and nurses are reported to be in short supply and are contributing to upward wage pressures in affected businesses. An acute shortage of nurses in the Southeast is expected to further escalate hospital costs.

Prices: Most input and product prices are said to be rising at a faster pace than last year at this time, but reported rates of increase vary widely by industry. A major distributor of auto, office machine and industrial parts notes that prices have been accelerating and pressures are the most intense in three years. Year-to-date in the firm's industrial supply division, price increases have averaged about 6 percent and forecasts are for some acceleration for the remainder of the year. Back orders at

suppliers are huge and delivery delays have been severe although some improvement has been noted in the last few weeks.

At the other extreme, prices of construction materials and products associated with the slowing building industry are generally feeling little or no upward pressure. The major exception is the price of cement which has increased 10 to 12 percent so far this year. Imported cement is primarily responsible for the upward price pressure. On the other hand, demand is slowing for lumber and additional softness is anticipated because of the slowdown in residential housing.

In agriculture, prices of vegetables have moderated with the regrowth of fresh vegetable crops since the February freeze. However, prices of broilers and eggs are holding at relatively high levels. The broiler industry is benefiting from rapid demand growth in the fast food industry, which is supporting prices at a highly profitable level for all chicken producers. Feed costs, though higher than a year ago, have not risen recently and there is hope that prospects for larger grain crops in 1989 may soon cause feed prices to decline. Last year's heavy losses drove egg producers out of the business reducing supplies and contributing to current high egg prices.

Capacity Utilization: Capacity constraints appear to be easing a bit throughout the Southeast. One capital equipment manufacturer notes that the rise in interest rates has caused distributors to trim inventories of products from a typical 4 and 1/2 months supply to a 1 and 1/2 months supply. This has resulted in a slowing pace of new orders for a formerly very active product line and is, in turn, reducing pressures to expand capacity. A number of other respondents note that new capacity is now coming on line reflecting past expansion decisions but few new expansions are planned for this year. A pickup in utilization of idle capacity is now anticipated for a number of energy producers. Spokesmen relate that an improvement in expectations for the oil industry over the long run is generating plans for some renewed activity in oil exploration. The natural gas industry is becoming especially active in response to brighter market prospects.

Investment: Capital investment appears to be slowing across the region. Some contacts state that uncertainty regarding the possibility of a recession by next year is causing reluctance in major expansion decisions. A medical services firm states that investment is being cut back from the levels of recent years partially because of efforts by businesses, insurers, and particularly the federal government to manage reimbursements of medical expenses more closely. For example, Medicare's reimbursement for capital expenditures has declined 10-15 percent this year and it is speculated that another 10 percent reduction is in the offing.

Most new capital investments are expenditures to upgrade machinery and production techniques which will enhance the output from the currently employed work force. In agriculture, crop farmers are sharply expanding purchases of machinery and equipment mostly to replace worn items that were held in service during the low-income period over the past several years. The broiler producing and processing industry is the major exception to the general trend. New processing plants are being built to respond to the brisk growth in the nationwide demand for chicken products. A significant investment to expand grower facilities is also required to supply the new processing capacity.

Credit Situation: Delinquency rates and defaults on real estate loans have continued to rise in the District although the extent of the problems is not yet considered serious. Several lenders report that loan volumes are flat or down reflecting the slowdown in both residential and commercial construction. A few lenders register concern that problems with large real estate development projects could become more severe in an environment of high vacancies and rising interest rates.

## SEVENTH DISTRICT--CHICAGO

Summary. Contacts in the Seventh District indicate that economic expansion is continuing but is less rapid than earlier. Payroll employment through February continued to trend upward in the District states about in line with the nation. Unemployment in the region averaged 5.3 percent of the labor force in February, down nearly to the national average of 5.1 percent after being higher since 1979. However, in March unemployment rose in Illinois and Michigan in contrast with the further national decline. Hiring plans are strong in the Midwest. Chicago purchasing managers surveyed in March indicated that expansion of production, orders, and backlogs continued but was less widespread than last year. This less heated expansion was reflected in prices paid, which showed widespread increases but less so than earlier. Milwaukee purchasers' reports have shown a similar trend over the past year. Higher petroleum prices are boosting costs for industry, transportation, and consumers. Contacts with industrial firms in the District have noted slower increases in orders or shipments for some types of machinery, paperboard, electronics, and rail transport. Others noted continued strength in the industries in which they do business, including industrial chemicals, industrial controls, construction steel, and heavy trucks. A diversified manufacturer with sales growing more slowly indicates that the slowdown is confined to U.S. markets, and that its overseas business is very robust. A minority among our sources indicated an expectation of an imminent U.S. recession. Others are cautious, watching closely for signs of weakness. Farm field work has been slowed by cool spring weather, and there is concern about dry conditions in part of the District.

Equipment. Reports on equipment markets are diverse, with strength widespread, but some sectors softening. A producer of various types of

machinery reported that its commercial machinery backlog is well above a year ago. Major home appliance shipments are at record levels. Demand is brisk for electrical equipment installed in construction projects. Industrial markets for electrical controls and related components are strong though some buyers expect a slowdown in this year's second half. Sales of equipment to utilities are holding up well after being very strong late last year. Demand for locomotives has improved but prospects are viewed very cautiously. Orders for defense machinery have declined significantly. Weakening was reported in light construction equipment, reflecting the housing slowdown. Signs of weakness in markets for material handling equipment were also noted. Petroleum equipment orders are low.

Construction. Nonresidential construction activity is at a relatively high level in the Midwest. Construction contracts for nonresidential buildings last year were at their peak for this expansion in the District states. Construction activity remains vigorous on office buildings in Chicago's Loop and on industrial structures. Chicago-area shopping centers, mostly in the suburbs, are set to open at a record pace in 1989 and 1990, even though some observers regard the area as already "overstored." Public works construction is expected to rise this year.

Residential construction activity is described as still vigorous in the Chicago area. Resales are slowing, however, attributed to higher interest rates. Housing prices are up sharply. Mortgage interest rates of 11 percent for fixed-rate loans became more widespread in March. Interest rates on adjustable-rate loans at area lenders climbed considerably in the year to mid-March. Mortgage rates, on average, have edged down since then.

Steel. Steel production in the District, through early April, was above a year earlier. Orders are also above last year. Demand from machinery

manufacturers reflects the continued growth of capital spending. Sales of construction steel are particularly strong--"through the roof," according to one source--at variance with weaker indicators of the pace of construction nationwide such as contracts. Auto and appliance markets for steel are holding up well.

Motor Vehicles. After another month of lackluster car sales and inventory accumulation at dealers, sales perked up in early April following announcement of enhanced buyer incentives. In addition, assembly plans for the second quarter were revised downward modestly in the past month, though they remain near last year's strong pace. Industry observers speculate that auto makers will stretch out third quarter model changeover shutdowns to pare inventories, though components suppliers reportedly are not seeing indications of this.

Truck sales in the first quarter were at a high level but somewhat below 1988's all-time high. Truck production, on the other hand, has been at a record pace. The heavy truck market is strong.

General Merchandise. Reports from retailers in the District were mixed. One noted that the shift in the timing of Easter, from April 1988 to March this year, renders questionable both comparisons of the latest month with a year earlier, and seasonally adjusted sales. Inventories are regarded as low.

Agriculture. Spring field work in District states is off to a slower start than in recent years, largely because of cool temperatures. There is considerable apprehension about the continuing drought conditions in much of Iowa and western Illinois. Elsewhere in the District, soil moisture appears adequate for the start of the growing season. In general, however, precipitation patterns over the next few months will be more critical to the development of spring-planted crops than the pattern of the past few months.

## EIGHTH DISTRICT - ST. LOUIS

Summary

Most sectors of the Eighth District economy continued to improve; however, there are many signs of weakness. Employment rose in all sectors except government and construction. While manufacturing employment rose, recent sales declines of autos and appliances have led to layoffs. District utility companies report increased usage of electricity. Nonresidential construction activity strengthened recently, but home construction and sales remain weak. Across virtually every loan category, except agricultural, first quarter loan volume is well behind that reported a year earlier.

Employment

District employment rose rapidly in recent months, continuing the strong growth that began last October. Payroll employment in the three months through February grew at a 6.3 percent annual rate, led by double-digit gains in the services, the transportation and communications and the manufacturing sectors. On the other hand, construction employment fell at an 8.2 percent rate in the same period, due to sharp declines in Missouri and Tennessee.

Implementation of the military base realignment and closure plan recently approved by the House of Representatives would result in additional jobs at three bases within District boundaries but would cause the eventual closing of a Army ammunition testing facility in southern Indiana, eliminating 400 jobs.

### Manufacturing

Manufacturing employment rose at a 10.8 percent rate in the December-February period with all major industries except electrical equipment producers experiencing gains. The chemicals and transportation equipment sectors posted the sharpest job growth. A St. Louis auto assembly plant temporarily laid off workers for one week in March to reduce auto inventories. Weak refrigerator sales prompted an Arkansas appliance producer to plan layoffs of 200 workers before May 1.

### Transportation and Utilities

During the first quarter, District airports experienced flat or declining passenger travel and cargo shipments compared to a year ago. Barge traffic on the Mississippi and Missouri rivers is near normal despite river levels remaining two to three feet below normal. District utility companies reported that increases in industrial demand for electricity ranged from 0.7 percent to 7.5 percent during the first quarter when compared to the same period a year ago, while increases in commercial demand for electricity ranged from 2.7 percent to 4.7 percent.

### Construction

The value of District nonresidential construction contracts rose 23.9 percent in the three months through February, compared to the three month average ending in November. The value of residential contracts rose moderately during the recent period, but are no higher than a year earlier. In the St. Louis area, first quarter housing permits were down 31.8 percent from a year earlier. A number of "move-up" buyers were prevented from ordering new homes as they were unable to sell their existing homes at their desired prices.

Consumer Spending

Retail sales of general merchandise have been moderately strong in March and early April in most areas of the District. In Arkansas and Memphis, however, wet and cool weather has hampered sales, particularly of summer clothes and merchandise. Generally, sales have met retailer's expectations, resulting in satisfactory levels of inventories. Sales of shoes, jewelry, and women's apparel have sold particularly well.

Agriculture

Consistent with farmers' intentions to expand planted acreage, operating loans this spring are considerably higher than a year earlier. April rains have helped drought-stressed wheat crops in northeastern Missouri and yields could be near normal. A heavy freeze in southern District states has damaged fruit and vegetable crops, with peach and fresh tomato growers experiencing the most damage. Consumers will only see small price increases, if any, due to the freeze, as the damaged areas produce less than 2 percent of the nation's peaches, and less than 5 percent of the nation's fresh tomatoes.

Banking

Total loans outstanding at the 12 largest District banks declined at a 0.7 percent annual rate in the first quarter, a sharp drop from the 5.9 percent rate of increase for the same period in 1988. Commercial loans fell at a 3.5 percent annual rate in the first quarter compared with a 15.5 percent rate of increase for same period last year. Consumer loan volume, which had shown some signs of strength earlier in the year, returned to its sluggish pattern. Real estate lending, spurred by home equity financing, grew at a 13.6 percent rate for the first quarter, slightly less than the rate a year earlier.

## NINTH DISTRICT--MINNEAPOLIS

Ninth District economic conditions have been generally good. The employment situation has been very good throughout the district. Consumer spending has been generally strong, although automobile sales have declined sharply. There has been some concern about rising prices. Conditions in resource-related industries have been good.

Employment

The employment situation has been very good throughout the district. The unemployment rate in Minnesota in February was 4.9 percent, 0.2 percentage points lower than in January and 0.1 percentage points lower than in February 1988. The unemployment rate in the Minneapolis-St. Paul metropolitan area dropped to 3.8 percent in February from 3.9 percent in January. Although labor market conditions are generally strong in Minnesota, a large computer manufacturing company closed its supercomputer division located in St. Paul and dismissed approximately 800 workers. The move was part of a nationwide cutback by the firm, which cost 3,100 workers their jobs.

The unemployment rate in North Dakota was 5.3 percent in February, down from 5.8 percent in January and 5.7 percent in February 1988. The unemployment rate in South Dakota was 4.5 percent in February, slightly lower than the 4.6 percent rate of February 1988. The unemployment rate in Montana was 6.4 percent in December 1988, up from 6.0 percent in November 1988. The unemployment rate in the Upper Peninsula of Michigan was 11.2 percent in January, up from 9.7 percent in December 1988 but down from the 13.9 percent rate in January 1988. A director notes that labor markets in western Wisconsin are tight, especially in the service sector, and that unemployment rates in the area are at their lowest levels for this decade.

Consumer Spending

Consumer spending on general merchandise has been fairly strong. One retailer reports strong sales in February and March with some signs of softening in early April. Another retailer reports that sales in March were up 14 percent over March 1988 and that year-to-date sales were up 15 percent from the comparable period of last year.

Car sales were down sharply from last year but truck sales held their own. Dealers for one domestic manufacturer report that car sales in March were 27 percent lower than in March 1988 and year-to-date sales were 15 percent lower than in the comparable period last year. However, they report that truck sales were 12 percent higher in March compared to March 1988 and 0.07 percentage points higher on a year-to-date basis. A dealer in the Minneapolis-St. Paul metropolitan area who sells cars from a number of manufacturers reports that the first three months of 1989 have been the worst in over twenty years.

Housing activity has been stable. The number of new housing permits issued in Minnesota was 24 percent higher in February than in January, although it was down 20 percent from February 1988. Home sales in the Minneapolis-St. Paul area were 11.4 percent higher in March from a year ago, although they were up only 1.2 percent on a year-to-date basis. Reports from Montana and South Dakota suggest that although new construction is slow, a substantial number of houses are being remodeled and upgraded.

A director surveyed several firms in a number of industries, from manufacturing through wholesaling, retailing, and contracting, and found that over 50 percent of the firms projected an increase in sales for the next year. Manufacturing firms, in particular, were very optimistic. In addition, two of the five manufacturers who were separately contacted reported plans to expand capacity this year.

### Prices

There is some evidence of inflationary pressures in the Ninth District. An index of prices received by Minnesota farmers was 3 percent higher in March than in February and 18 percent higher than in March 1988. Unleaded gasoline prices in the Minneapolis-St. Paul metropolitan area were 12 percent higher in April than a year ago. A director reports that manufacturers have recently raised prices fairly sharply.

### Resource-Related Industries

Conditions in resource-related industries have been generally good. Reflecting the rise in prices received by farmers, the average value of Minnesota farmland rose by 9 percent during the year ending July 1988. Farmland values rose in all parts of the state except northeastern Minnesota. The greatest gain, 17 percent, was in the southwestern part of the state. Agricultural areas throughout the district reported adequate snowfall in the winter. Soil moisture levels were slowly recovering from the effect of last year's drought. Flooding in the Red River Valley of North Dakota has increased soil moisture content in that area. However, farmers in South Dakota continued to be concerned over low soil moisture levels. The district's lumber industry continued to enjoy strong demand for its products. The major problem facing the lumber industry has been ensuring adequate supplies of raw materials. Environmental concern has delayed logging activity. A large paper products manufacturer plans to expand its facilities in Minnesota, adding about 190 permanent jobs and employing up to 2,000 people during construction. Mining activity in Montana and the Upper Peninsula of Michigan continued to be strong.

TENTH DISTRICT - KANSAS CITY

Overview. The Tenth District economy continues to grow slowly. Retail sales are increasing moderately, though new car sales are down. Manufacturers report higher input prices, but no bottlenecks or labor shortages. The district's energy industry shows few signs of improvement. Housing starts have been relatively weak so far this year, although they were stronger in March. Mortgage demand is mixed at district savings and loan institutions. Loan demand at commercial banks is steady to higher, while deposit performance is mixed. Recent rains have improved the outlook for spring crops, but winter wheat yields are still expected to be below normal. Bankers report generally strong financial conditions among farmers and ranchers.

Retail Sales. Most general merchandisers report retail sales performance has improved from a year ago and over the last three months, although a few report decreasing sales. Retailers are attempting to maintain margins by passing through wholesale price increases. In the near-term, retail sales are expected to be stable to slightly higher. Inventory levels are mostly satisfactory. Automobile sales are reported to have weakened over the last month. Most dealers are trimming inventories or maintaining current inventory levels. Most auto dealers expect 1989 sales to be at or below 1988 levels.

Manufacturing. All respondents indicate that input prices are up relative to a year ago, with some increases over the past three months. Prices are expected to stabilize or decrease in the future. Firms report few difficulties in acquiring materials, and lead times have remained steady or declined. Inventory levels are generally satisfactory. Most plants are operating near full capacity, but no bottlenecks or labor shortages are reported.

Energy. Despite the recent run-up in oil prices, the district's energy industry shows few signs of improvement. Continued uncertainty about the future course of world oil markets has held down drilling activity in the region and nationwide. The average number of active drilling rigs in the district fell from 219 in February to 211 in March, a fourth below the average of one year ago. However, during the first two weeks of April, the district rig count increased to 233.

Housing Activity and Finance. District housing activity through March is down from a year ago. However, most homebuilders report stronger housing starts in March, a rebound from February's weakness. Single-family construction continues to be stronger than multi-family. New home sales and prices are higher, but the higher prices reflect larger homes being sold. Home inventories are relatively low. Most respondents expect steady housing activity in the near term, and slightly improved activity by year-end.

Most respondents from district savings and loan institutions report a net outflow of deposits over the last month. In most cases, net flows of deposits are comparable to a year ago. Respondents' expectations for deposit flows in the near future are mixed, but several expect further outflows if interest rates keep increasing. Respondents report mixed demand for mortgages, with a pickup expected during the summer. Many respondents expect mortgage rates to peak within the next three months and then to decline for the rest of the year.

Banking. Most district commercial bank respondents report constant or increased loan demand over the past month. The increases were concentrated in commercial and industrial loans and in agricultural loans. About half of the respondents increased both their prime rate and their consumer loan rates by fifty basis points in recent weeks, while the other half reported no change.

Only a few banks expect further increases in lending rates in the near future; the remaining banks anticipate no change. Deposit behavior varied both across the district and across types of deposits. Approximately equal numbers of respondents reported increases and decreases in deposits. Decreases were mostly in demand deposits, NOW accounts, and money market deposit accounts. Increases were generally in IRA and Keogh accounts and in small time and savings deposits.

Agriculture. Recent rains throughout much of the Tenth District improved the district's agricultural outlook, but the rains came too late for much of the winter wheat crop. Continued dry conditions throughout the spring and cold temperatures in February severely damaged much of the crop. Wheat yields are expected to be well below normal in parts of Oklahoma and much of Kansas. Bankers in those areas report that some farmers are plowing under the wheat crop and planting spring crops. In other areas of the district, the recent moisture has allayed fears of losing the wheat crop, although additional rains are needed to assure adequate spring growth. District bankers report most farmers will begin planting spring crops within the next few weeks. The recent rains have contributed to good growing conditions and an optimistic outlook for spring crops, although more moisture will be needed soon. Subsoil moisture remains below normal in many areas of the district; good snowpack in Colorado will help replenish depleted water stocks there.

Results of spring credit reviews by district bankers generally reflect strong financial conditions among farmers and ranchers. Most operators had good financial performances both last year and the year before. Given the relatively strong financial conditions of borrowers, most bankers do not feel that their agricultural loan portfolios are at risk, especially if dry conditions affect only the wheat crop and normal weather returns to the rest of the district.

## ELEVENTH DISTRICT--DALLAS

The District economy is growing modestly, but persistently. Manufacturing sales are increasing at a slow pace. Retail sales growth generally is moderate to strong, while auto dealers say their recent sales have been about the same as last year's. Construction activity is slipping a little. The oil and gas drilling upturn that began in February continues unabated. In agriculture, the drought is becoming a more serious problem, but product prices are up.

District manufacturing is expanding overall. Growth has recently been slow and respondents are expressing increased uncertainty, but most are still optimistic. Sales by oilfield equipment producers have not generally risen, despite a recent upturn in oil and gas drilling activity. Respondents anticipate modest increases in demand as the energy industry continues its recovery. Although primary metals orders have changed little in recent months, sales are up over a year earlier. Fabricated metals producers say their recent increases in orders mostly reflect a seasonal pattern, but they express optimism about continued sales growth later in the year. Demand for electronics has picked up after some recent sluggishness, and manufacturers expect further growth in 1989, although at a slower rate than during the first half of 1988. A number of firms in this industry are planning significant increases in investment spending. Some electronics firms cite shortages of engineers and technical workers. Stone, clay and glass sales are generally sluggish, but it is widely believed in this industry that demand has reached its trough. Most lumber and wood manufacturers report no change in sales.

Apparel orders are up. Reports on paper sales are mixed, but those with growing sales express concern that their inventories are too low. Demand for District chemical and plastics products has lately been flat to down and producers say uncertainty over future demand patterns has increased. Most manufacturers still report little or no upward wage pressure, but more of them are reporting pressures than in recent surveys. Many manufacturers, however, note that their employee health insurance and workman's compensation costs are rising significantly and one respondent cited these increases as a motivation for expanded offshore operations.

District retail sales growth ranges from moderate to strong. Rates of expansion have been particularly high in the cities on the Mexican border and in the eastern portions of the Texas gulf coast. Growth has also been brisk in Dallas. The pace of growth has slowed somewhat in Houston and San Antonio, where expansion was strong in 1988, but increases continue.

District auto sales are generally little changed from a year ago. Dealers expect future growth with the continuation of the District recovery and also because of current promotion programs.

Construction activity remains sluggish. Contract values overall are slipping a little, mostly as a result of weakness in nonbuilding construction. Although gains in residential building have lost some of the momentum they developed during 1988, this measure remains farther above its year-earlier level than at any time in the last 4 years. Permit issuance for multifamily residences is very low. Single family permits also have weakened somewhat but, unlike the multifamily side, are above their year-earlier levels. Nonresidential building activity has stabilized and is still showing year-

over-year gains in contract values. Texas construction employment dropped sharply in February, following a large increase in January.

District oil and gas drilling has recently picked up. After declining from June 1988 until January of this year, the District rotary rig count increased slightly in February and was up strongly in March. Recently revised data reveal that oil consumption is stronger and inventories are weaker than previously estimated. The new estimates increase the likelihood that oil prices at or above \$18 per barrel could be sustained throughout this year and into next. Respondents say that this should stimulate some growth in drilling although strong expansion is not expected.

Drought remains a serious threat to District agriculture as soil conditions continue to worsen in Texas and New Mexico. The winter wheat crop has been seriously damaged by insufficient moisture and by insects. In Texas, 85 percent of the crop is rated either fair or poor, and the damage is even greater in New Mexico. The drought has affected livestock operations also. Despite signs of nationwide herd rebuilding, cattle liquidation continues in the District, due to a lack of forage availability. While rainfall remains below normal levels, moisture has been sufficient for planting, but dry conditions have slowed seeding operations in the southern half of Texas. Because of the composition of its output, the District's agricultural prices are rising faster on average than nationally.

## TWELFTH DISTRICT -- SAN FRANCISCO

Summary

The Twelfth District economy continues healthy, although there are signs of slowing in some sectors. Manufacturing activity overall continues strong, and agricultural conditions have improved in the West. Retail sales are reported to be sluggish. Most District business contacts expect slower economic growth during the next year. Conditions in the forest products and financial industries are reported to be mixed. Oil prices have risen sharply on the West Coast since the Alaska oil spill. Real estate activity continues strong in most parts of the District, although some signs of slowing are emerging.

Business Sentiment

Most Twelfth District business leaders contacted in early April expect slower economic growth during the next year, with fifty-six percent expecting GNP growth during the next four quarters to be slower than it was in 1988. Responses indicate weaker growth prospects for business investment, consumer spending, housing starts, and the trade balance. Housing starts are the weakest sector, with 92 percent of District business contacts predicting slower activity during the next year.

Consumer Spending

Several respondents report sluggish retail sales in recent weeks. One notes that the weakness could be related to the early Easter, or to unseasonable weather. Several note that sales of soft goods, including housewares and women's apparel, are relatively stronger than are sales of big-ticket durable items such as furniture and electronics.

Auto sales are reported to be slow throughout the District, a condition many attribute to higher interest rates. One auto dealer reports that, although sales were up sharply in early April, the increase was no more than seasonally expected, despite sales incentives. Moreover, he notes that the recent jump was not enough to take the pressure off dealers. Prices are still soft, and dealers are ordering very cautiously to avoid excessive inventory buildup.

### Manufacturing

Manufacturing activity overall continues strong. The aerospace industry continues to experience strong commercial aircraft demand in the face of limited production capacity. Boeing, for example, currently has an order backlog in excess of \$55 billion and is late with deliveries of its 747-400. To boost production, the company has arranged to borrow more than 600 skilled mechanics from Lockheed for periods ranging up to six months, in addition to continued heavy hiring of permanent employees. Local firms complain that Boeing is hiring workers away at wages they are unable to match. Despite Boeing's efforts at increased production, the backlog of orders continues to rise due to the large volume of new orders received.

Most other manufacturing sectors report more moderate growth, although activity appears to be weakening in product lines tied to construction activity. For example, demand for paints and coatings is flat compared with a year ago, and a large floor covering distributor reports a 12 percent decline in carpeting sales from last year's level.

### Agriculture and Resource-Related Industries

Agricultural conditions have improved in the West. Heavy March rains eased the drought in most of California's agricultural regions, although water supplies remain low for some areas of Southern California, Arizona, and parts of Idaho. Unusually hot weather in early

April damaged the strawberry crop in California and threatens to limit grazing in Arizona. Low inventories of grain seeds have caused seed prices to rise by as much as 50 percent over last year's level. Consumption of apples and grapes is returning to normal, following sharp declines triggered by the Alar and Chilean grape scares, respectively. Seafood prices are stable despite the oil spill in Alaska.

Conditions in the forest products industries are mixed. Consumption of linerboard and boxes is rising at a 2 percent rate, while newsprint consumption has fallen with a decline in classified advertising. Shortages of logs have boosted prices despite slowing consumption by the construction industry. Lack of available logs has caused some lumber mills to reduce capital expenditure plans, and one lumber industry contact reports reducing his firm's capital expenditure budget to a third of its originally planned level. Further expansion is anticipated at paper mills.

Oil prices have risen sharply on the West Coast in the aftermath of the Alaska oil spill. Sources in Alaska report that the spill is helping the Alaskan economy at the moment, with fishermen being paid \$2,500 per day for use of their boats in the clean-up operation. Exxon has told area residents that the company will compensate them for all reasonable claims of lost income resulting from the spill.

#### Construction and Real Estate

Real estate activity continues strong in most parts of the Twelfth District, although some signs of slowing are emerging. Home prices in California and Washington continue to escalate, with multiple offers above asking price now occurring frequently in Seattle. However, construction activity is limited by a lack of available urban land and, more recently, by a more cautious attitude engendered by higher interest rates. Moreover, one respondent notes that his

company has postponed some construction projects due to the recent interest rate hikes.

Financial Sector

Many banks and thrifts report that demand and savings deposit balances have fallen in recent weeks, as consumers shift funds toward money market funds, certificates of deposit, or treasury bills in response to higher interest rates. Most report weak demand for consumer loans. The relatively healthier demand for mortgage and home equity loans is attributed by many to federal income tax considerations. One banker notes that although his institution is generating few new loans, most of those issued are going to well-qualified borrowers. Financial institutions are fairly evenly divided between those reporting narrower and wider interest spreads as rates have risen.