

SUMMARY OF COMMENTARY

ON

CURRENT ECONOMIC CONDITIONS

BY FEDERAL RESERVE DISTRICT

January 1991

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SUMMARY*

The level of economic activity appears to be declining in most districts. The Persian Gulf situation is frequently cited as a key determinant of both current and future economic activity. Nominal retail sales during the holiday season differed little from a year earlier. Inventories are near their desired levels. Despite continued export growth, manufacturing orders, employment and shipments have weakened. Construction activity continues to slow in most districts, and interest rate declines have done little to stimulate residential housing demand. Inflation does not appear to be accelerating. Widespread weakness exists in home sales and consumer and business loan demand. Some state and local governments are experiencing revenue shortfalls. Farm income prospects have weakened somewhat, while the mining sector shows strength.

Consumer Spending

Nominal retail sales during the holiday season were near year-earlier levels, implying declines in real terms. Sales of big-ticket items were particularly weak. Boston, New York, Philadelphia, Richmond, Atlanta, Chicago, Minneapolis and Dallas mention that price discounting was used to move goods. Despite the reported dampening effect of the Persian Gulf conflict throughout the holiday

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season, some Districts noted improved sales toward the end of December. Most districts that mention inventories report they are generally near desired levels. The outlook for retail sales in most districts is for continued sluggishness, with retailers in Philadelphia and Cleveland not expecting any upturn before the third quarter of this year.

Four districts indicate that car sales are weakening or lower than a year earlier while Dallas indicates increasing sales, especially in the Houston area. Auto inventories are moderate to high in the Minneapolis district, while Kansas City reports that dealers are trimming their inventories. Cleveland indicates that domestic car dealers are not adding to their inventories, in contrast to their Japanese counterparts who are increasing inventories in anticipation of higher spring sales.

Manufacturing

Nearly all districts report weak or declining manufacturing activity. While domestic demand is generally weakening, Boston, Atlanta, Chicago, Minneapolis, Kansas City, Dallas and San Francisco indicate that export growth continues to be strong, or at least stronger than domestic growth. Cleveland, Chicago and St. Louis note a downturn in auto production that had spread to related sectors. Cleveland and Chicago, for example, note sharp declines in steel production. Boston and St. Louis report that layoffs are expected among defense contractors, and San Francisco reports that defense-related aerospace activity remains weak. The outlook for the manufacturing sector is clouded by the Persian Gulf situation, with some districts indicating that the timing of an upturn is dependent on a resolution of that conflict. Contacts in the Boston, Philadelphia, Richmond and Dallas districts, however, do not expect a turnaround before the third quarter.

Construction and Real Estate

Despite pockets of strength, most districts describe residential and nonresidential construction activity as down more than usual for this time of year. Housing starts are below year-ago levels in most districts, and high and climbing vacancy rates in many large urban areas have discouraged commercial office space development. Contacts in the Dallas district, however, report a modest increase in construction activity, especially in Houston and South Texas. Recent declines in interest rates and home prices have done little to buoy demand for new or existing homes in most districts. Contacts cite uncertainty about the future course of economic activity and the Persian Gulf crisis as the major factors dampening residential housing demand. New York reports that some district lenders and developers have held auctions to pare housing inventories.

Prices

Several districts report little evidence of increasing inflation. San Francisco reports that wage and price increases continue to slow, and Minneapolis notes that they have remained moderate. Cleveland contacts expect the inflation rate to decline from recent levels. Manufacturing input and output prices are generally stable, although Richmond reports increased raw materials prices. Districts report declining oil and natural gas prices, but mixed movements in motor fuel prices. Grain prices are generally falling, while beef, citrus and log prices are showing strength.

Banking and Finance

The majority of districts report weakness in business and consumer loan demand, largely due to the slowdown in the economy and the Persian Gulf. Real estate lending is edging downward in many districts, despite

declines in mortgage interest rates. Commercial real estate and construction lending are especially weak. Atlanta reports that many businesses have reduced or delayed planned capital expenditures. Cleveland notes that signs of consumer financial difficulties are emerging, as evidenced by increases in auto repossessions and home foreclosures in some parts of the district.

State and Local Government Finance

State and local governments in the New York, Richmond, St. Louis and Dallas districts are either expecting or experiencing revenue shortfalls because of weakening economic conditions. In some cases, increased government spending was also cited as contributing to the governments' financial strain. A variety of measures, including reduced spending and layoffs, are being taken or are anticipated to avoid budget deficits.

Agriculture and Natural-Resource-Related Industries

Kansas City and Richmond indicate that farm income prospects for 1991 have dimmed because of an expected cost-price squeeze. Chicago notes that agricultural exports have fallen sharply in recent months. A recent freeze and a continuing drought are causing major problems for California's agricultural sector. Winter grain crops are reported to be in good condition, although Minneapolis notes potential problems later this year because of below-normal precipitation this winter.

Energy extraction has increased in the Dallas and St. Louis districts, while Kansas City indicates that growth in the the number of operating drilling rigs has leveled off. Minneapolis reports that conditions in the mining industry have been fairly good. San Francisco, St. Louis and Atlanta report weak or declining activity in the forest products industries.

FIRST DISTRICT-BOSTON

Economic conditions continue on a downtrend in the First District. A majority of manufacturing contacts report dwindling order backlogs and delivery times. While planned capital expenditures generally remain above depreciation, many projects are under review. According to respondents and press announcements, further declines in employment are likely. Manufacturers hope to see signs of improvement in the second half of this year. Retailers typically report declines in Christmas season sales from a year ago, and they anticipate intense competition for market share in 1991. Half express concern about the effect of banking failures on the availability of credit for inventory financing.

Retail

For the Christmas season, the panel of First District retailers report that sales typically declined by single-digit percentages from a year ago. However, department store results ranged from flat to double-digit declines, while other contacts whose business is not closely tied to Christmas report flat to slightly higher sales. Sales results were dampened by widespread promotional activity and consumers' preference for basic, low-priced gift items.

During the last six weeks, one large New England discount chain has filed for reorganization under Chapter 11 of the federal Bankruptcy Code. Another large department store chain has announced plans to close three stores in New England and a fourth in New York state.

Half the retail contacts expressed concern that the recent failure of financial institutions in New England will lead to difficulties in obtaining inventory financing. Additional respondents cite lack of credit as a constraint on expansion.

Retailers are approaching 1991 with great caution, given falling consumer confidence and rising unemployment. They anticipate intense competition for market share and are attempting to control costs by pursuing conservative policies for spring orders and employment.

Manufacturing

A majority of First District manufacturers contacted report that sales are flat to down compared with year-ago levels, with declines ranging from 4 to 8 percent. A minority continue to see year-over-year sales gains. For most respondents, incoming orders are below late 1989 levels (by 7 to 25 percent), and backlogs and delivery times are dwindling. For some, the downturn in orders began early in the fall; for others it began three to four weeks ago. The slowdown is reportedly widespread, by geography and sector. Demand for unique or customized products and for telecommunication and (some) aerospace equipment remains relatively robust. Several respondents also find that demand is stronger abroad, particularly in Europe, than in the United States, but economic difficulties continue in Canada, the United Kingdom, and Australia.

Inventories are at satisfactory levels at almost all manufacturers contacted; only one firm idled plant to reduce stocks. Employment is little changed from year-ago levels at one-half of the respondent firms; elsewhere layoffs have reduced employment by 6 to 11 percent. Roughly one-third of the contacts anticipate further layoffs. Recent

press statements also indicate that the District's computer and defense industries will see additional cutbacks in employment.

More than half of the manufacturers contacted reduced their 1990 capital expenditures below the amounts originally budgeted. Respondents continue to conserve capital, and in 1991 most expect to invest very little beyond essential amounts. By exception, two firms plan to increase capacity for specific products.

Input costs are generally said to be stable. A few firms mentioned increases in paper and health insurance costs, modest oil-related surcharges for transportation services, and the rise in postal rates slated for February. By contrast, prices for metals and computer chips have fallen. Roughly one-third of the respondents recently raised their own sales prices by 7 to 8 percent from year-earlier levels, but one firm had to rescind an increase. Several respondents are granting discounts.

First District manufacturers describe their mood as sober; they expect a "very difficult" first half to be followed by a "difficult" second half. Few anticipate any turnaround before the third quarter. Several respondents serving the construction industry pointed out that construction will not buoy the economy any time soon. By contrast with 1981-82, little pent-up demand for housing exists, and current vacancy rates are high. Moreover, just-in-time inventory systems save space and permit firms to consolidate plants. Nevertheless, respondents believe that lean and careful companies will weather the coming storm.

SECOND DISTRICT--NEW YORK

Developments in the Second District economy since the last report remain soft to mixed. Retail contacts reported disappointing sales results on balance despite some improvement just before and after Christmas. The underlying demand for new homes remains weak, and office vacancy rates in Manhattan rose somewhat further from already high levels. More positively, both the Buffalo and Rochester surveys of purchasing managers reported an increase in firms with improved business conditions in November, though more recent news from upstate New York suggests some slackening. Nearly all small and medium-size banks surveyed reduced their prime rate recently.

Consumer Spending

District retail contacts reported disappointing sales results in both November and December though several experienced a decided improvement during the last two weeks of the year. The sales environment was very competitive and marked by a high level of price-cutting throughout the period even though most stores entered the holiday season with inventories substantially reduced from year-earlier levels. Retailers cited concerns about impending layoffs and the Middle East crisis as well as unseasonably warm weather for the recent consumer apathy. Over-the-year sales changes at department stores ranged from -3.5 percent to -13 percent in November and from flat to -14 percent in December. A survey conducted by the Retail Council of New York State covering some 200 stores across the state found sales during the pre-Christmas period to be basically unchanged from a year earlier.

Items which sold well included some women's and children's apparel, men's shirts and costume jewelry as well as certain toys. Furniture and rugs remained weak, however, and sales of cold weather items such as outerwear and comforters were also slow. Due in large part to a pickup in sales during the last two weeks of December, inventories are generally at or slightly below targeted levels.

Residential Construction and Real Estate

Homebuilding activity is seasonally slow throughout the District. Moreover, the underlying demand for new homes remains weak. A glut of homes for both resale and initial purchase continues to plague most of the New York metropolitan area and has spread to upstate areas as well. Sales in some New York City cooperative and condominium apartment buildings have slowed to such a point that one realty firm recently announced plans to hold an auction for individual apartment owners. Some developers and lenders in the District have already been holding auctions in order to pare their housing inventories.

Office vacancy rates in both midtown and downtown Manhattan moved higher in recent weeks. In midtown, where an additional 2 million square feet of space is scheduled for completion in 1991, the higher rate resulted from slow leasing activity over the past few months. Although leasing activity has been more brisk in downtown Manhattan, blocks of excess space continue to be added to the market in the wake of consolidations and cutbacks in the financial services sector. Elsewhere in the District, the recent annual survey of Buffalo's downtown office space found the vacancy rate there had jumped to the highest level in more than five years, in part due to restructuring in the financial services sector.

Other Business Activity

Both the Buffalo and Rochester surveys of purchasing managers reported an increase in the percentage of firms with improved business conditions in November. However, more recent news reports from upstate suggest that some slackening in economic activity is now occurring. Several of these communities are hopeful that Canada's mid-December imposition of a 7 percent sales tax will bring an increase in Canadian shoppers.

The unemployment rate rose in New Jersey during the last quarter of 1990 but showed little change in New York State. In December, New Jersey's rate stood at 5.9 percent, up from 5.2 percent in September while New York's

December rate of 5.5 percent was unchanged from September. Although New York's unemployment rate has remained stable, some observers are concerned because the number of employed persons has declined. Both New York City and State anticipate substantial layoffs more because of their budget gaps, and several corporations have announced impending cutbacks as further restructurings occur. One possible bright spot: the Navy is reportedly considering modifying an old Grumman jet fighter built on Long Island now that the Pentagon has canceled further work on the A-12 attack plane.

Financial Developments

Nearly all small and medium-size banks surveyed in the Second District recently reduced their prime rate. When asked what factors determined their bank's decision, most senior loan officers indicated that their banks tend to follow a particular bank or large money center banks while taking into account their credit risks, competitive environment, and profitability. Bankers generally reported that from twenty to thirty-five percent of loans outstanding are directly tied to the prime. The vast majority of their loans are above prime, usually by one or two percentage points. Most bankers stated that the reduction in the prime had not affected other lending rates but some banks did lower rates on other business and commercial real estate loans. A few banks also reported a slight easing of rates on some categories of consumer loans.

Most of the bankers surveyed indicated reduced willingness to make business and real estate-related loans. Respondents were evenly divided on the desirability of making consumer loans between "willing", "less willing", and "not willing". Most banks reported some strength in demand for either consumer or commercial real estate loans, but two noted weak demand in all sectors. Half expected loan demand to increase over the next three months, and half expected loan demand to weaken or stay unchanged. Factors contributing to reluctance to lend over the next few months included a national recession and a worsening of local unemployment and business failures.

THIRD DISTRICT - PHILADELPHIA

Signs of softening activity were apparent in most sectors of the Third District economy in early January. Manufacturers continued to report declining business and employment. Retailers generally reported flat sales for the Christmas shopping season, in dollar terms. Bankers indicated that commercial and industrial lending was edging down and growth in consumer lending was slackening. Real estate lending remained curtailed and debt restructurings were beginning to reduce outstanding commercial real estate debt.

The outlook is clouded by potential developments in the Persian Gulf crisis, according to business contacts. They are virtually unanimous in citing the situation, however it is resolved, as a depressing influence on their own businesses. Looking beyond the crisis, expectations are that the economic slowdown will last through most of the year and perhaps into early 1992. Manufacturers' overall view of the economy is pessimistic, and they plan to make more cuts in employment and capital spending. Retailers generally expect only a slow improvement in sales beginning late in 1991, and then only if there are clear signs of renewed economic expansion to boost consumer confidence. Bankers expect weak loan demand through most of the year as both businesses and consumers cut spending plans. Bankers also indicated they will continue to limit commercial real estate lending; it appears that debt restructurings in this segment of real estate lending, combined with slow residential activity, will result in a reduction in total real estate loan volume outstanding.

MANUFACTURING

Manufacturing activity in the Third District continued to slip as the new year began. Nearly half of the industrial firms polled in January indicated that

business was falling off from December while only one-in-eight noted improvement. Although nondurable goods producers generally were experiencing relatively weaker conditions than durable goods makers, negative reports outnumbered positive indications in every major industry segment except electrical machinery.

Overall, Third District manufacturers said they were continuing to see drops in shipments, new orders, and order backlogs. Employment was also softening, on balance. While half of the firms contacted were maintaining steady employment, one-third were cutting work forces and an equal number were reducing working hours. Industrial prices are apparently responding to the slackness in the manufacturing sector. While a slight majority of area firms reported that they were maintaining steady prices for the goods they make, prices were being reduced by one-out-of-five companies surveyed; and, although nearly one-third noted rising input costs, more than half indicated that the prices of the goods they buy were unchanged from a month ago.

Looking ahead, negative expectations edge out positive views among Third District manufacturers, and the balance of opinion is that the current down trend in industrial activity will continue to midyear. Individual forecasts vary considerably but, overall, managers at area plants expect no growth in either new orders or shipments over the next six months. In response to the dim outlook, local manufacturers plan to trim employment further and they intend to scale back capital spending slightly between now and midsummer.

RETAIL

Reports from merchants indicate that sales for the Christmas season ran even with 1989 results, in dollar terms. Some stores made slight gains and a few fell well below their year-ago performance. Nearly all store executives contacted for this report said they made extensive reductions from original selling prices in order to meet sales targets. As a result, it appears that volume sales goals were nearly achieved and leftover inventories are not

significantly higher than anticipated.

Store officials said they continue to be extremely cautious in planning for the rest of the year. In their view, near-term prospects depend on developments in the Persian Gulf and their effect on consumer sentiment. Looking somewhat further out, merchants generally do not expect sales to improve until the second half, and then only if the overall economy shows signs of renewed vigor and consumer confidence improves.

FINANCE

Total loan volume at major Third District banks in late December was approximately 9 percent above the December 1989 level, with growth largely due to gains in consumer lending. Commercial and industrial loan volume was down slightly, year-over-year, and bankers contacted in January said demand for business loans remained weak. Real estate loan volume was up from year-earlier levels, but bankers indicated that outstandings were beginning to decline as a result of payoffs and commercial real estate loan write-downs while new loan commitments remain limited. Personal lending in late December was up, but the gain appeared to be less than the usual seasonal increase, and bankers indicated that growth appeared to be easing in early January.

Bankers generally expect weak loan demand throughout the year. They cite the Persian Gulf situation as a restraining influence on the demand for credit; and, looking further ahead, several bankers said they expect an economic slowdown to persist well beyond midyear, further dampening the demand for loans by businesses and consumers.

FOURTH DISTRICT - CLEVELAND

Summary. The worst of the contraction in real GNP and industrial production occurred last quarter, according to a panel of 23 Fourth District economists. Labor markets in Ohio have held up better than for the nation in recent months, but the unemployment rate is expected to rise more rapidly in the next few months. Manufacturing in the Fourth District has also fared better than in the nation, but conditions in the automotive, capital goods, and steel industries have deteriorated in recent weeks. Most retailers report that sales in late December and early January picked up from the weak performances in October and November. Lower interest rates have not had a visible effect on loan demand, which remains weak.

The National Economy. All but two of a group of 23 economists with the Fourth District Roundtable believe that the worst of the contraction in real GNP and industrial production occurred last quarter. They estimate that real GNP declined at about a 2.7% annual rate in 1990:IVQ, and will decline at rates of 1.7% and 0.2% in the first and second quarters of this year. Growth in real GNP is expected to rebound at a 2.7% annual rate in the second half of 1992 and a 3% rate in the first half of 1991. The forecasts assume no outbreak of war in the Middle East.

The panel also believes that the worst of the latest inflation bulge was in 1990:IVQ, when overall prices rose at an estimated 4.9% rate. Prices are expected to increase by about a 3.3% annual rate between 1991:IIIQ and 1992:IIQ.

The Regional Economy. Labor market conditions in the District have remained better than in the nation. Nonfarm employment in Ohio inched up in December, and was slightly higher than a year earlier. The unemployment rate rose 0.3% in December but averaged 5.7% in the latest three months. Some labor market officials believe, however, that the unemployment rate will rise more rapidly toward the national average in the next few months, especially because of further layoffs in the automotive and steel industries.

Manufacturing. Output and employment have been stronger in the District than in the nation, but deterioration occurred in key industries during December, resulting in sizable layoffs in mid- and late January especially in the automotive industry. Auto production this quarter, however, is expected to increase by about 5% to 10% from the weak fourth quarter, according to several auto analysts. A similar increase in production is expected for next quarter, assuming revival in consumer confidence if the instability in the Persian Gulf is resolved.

Some capital-goods producers have marked down their forecasts of output for this year because of a weaker-than-expected economy. Nevertheless, a common view is that capital spending will hold up better than it did in past periods of business weakness. A machine tool builder reports that orders have been declining in each of the last three months, but the declines have been far less than in previous episodes of business slowdown.

Heavy-duty truck business sagged unexpectedly in November and apparently in December, following a brief revival through mid-autumn when orders were

pulled forward into 1990 because of new environmental regulations effective in 1991.

Steel producers report a sharp deterioration in orders and operations in recent weeks. The drastic cutback in auto output last month and higher-than-expected volume in steel imports last quarter cut the operating rate in the domestic steel industry to about 70% of capacity late last month from an 84% rate in November. Operations are expected to average in the low 70s this quarter.

A defense contractor noted substantial pickup in the last few months for special military goods destined for the Middle East. They anticipate, however, no reversal in the decline of defense spending, and have not experienced a revival in defense orders.

Consumer Spending. Most retailers report that sales in late December and early January improved from a weak October and November, but sales were widely mixed among retailers. Consequently, inventories for some retailers are in better balance now than before the Christmas season, while a little higher than desired for others. Retailers see little prospect that sales will improve much, at least until the Gulf situation is resolved. Improved real income, especially because of lower gasoline prices, is a positive sign for near-term sales, but most retailers expect consumer spending will be lackluster through midyear.

New car dealers in the District report that sales have weakened sharply for this time of year, but that inventories of new cars are lower than a year ago. Dealers have no trouble obtaining financing for inventory, but report

that consumers are finding financing more difficult than a few months ago. Dealers of domestic nameplates are not ordering for additional inventories, but Honda and Toyota dealers apparently are adding to inventories in anticipation of higher sales in the spring.

Financial Developments. Latest interest rate declines have had no visible effect on demand for credit by consumers or businesses. Lenders assert that rising concerns over employment and uncertainty about the Persian Gulf situation are constraints on consumer demand. Rates on conventional 30-year fixed-rate mortgages in the Cleveland area average about 9.5%, with some lenders offering mortgages as low as 9.0%, but without much consumer response.

Builders of new homes claim that construction is off more than usual for this time of year, and a major developer cancelled plans for a shopping mall because of the uncertain economy and increased difficulties in funding from his usual sources of credit.

A reasonably well-capitalized bank with a large portfolio of real estate loans is shifting away from commercial loans toward consumer loans. Some other well-capitalized banks still report that they have an ample supply of credit available to qualified borrowers, but loan demand remains weak.

FIFTH DISTRICT-RICHMOND

Overview

District economic activity weakened further in late December and early January. Sales activity was slow for District retailers, manufacturers, realtors and auto dealers. Manufacturers apparently decreased production and home builders started relatively few houses. Financial institutions reported weak loan demand, and hotels and resorts experienced a downturn in occupancy. On a positive note, export volume increased again at District ports, and the region's farm sector was healthy.

Consumer Spending

Responses to our post-Christmas mail survey of retailers indicated that Christmas and post-Christmas sales were disappointing. A majority of the respondents reported that Christmas sales were below year-ago levels, and many stores also reported declines in shopper traffic and sales of big ticket items. More than nine out of ten retailers indicated that they had employed fewer workers than last Christmas, and about two-thirds indicated that they had reduced their prices as December progressed. Retail inventories apparently changed little over the survey period.

Manufacturing

District manufacturing activity fell in December according to our regular mail survey. Weakened demand was apparent as orders and shipments declined from November levels, and manufacturers cited poor sales as their biggest problem. Responding firms cut back production, employment, and their workweeks. The prices they paid for raw materials rose.

Most manufacturers believed that the business climate declined nationally and locally in late December and early January. They expected little improvement over the next six months, and only a third foresaw increased profits for their businesses in 1991.

Ports

District ports--Baltimore, Charleston, and Hampton Roads (Norfolk)--indicated that exports rose while changes in import volume were mixed in December compared with November and a year earlier. All ports expected export growth to outpace import growth over the next six months. Hampton Roads reported that its coal exports were at a record pace in late 1990.

Residential Real Estate

Housing sales were generally weak in December, according to our telephone survey of District realtors. Sales of new homes were poor, but sales of existing homes remained stable. Also, sales of expensive homes slowed more than sales of modestly priced homes. Realtors indicated that housing prices had changed little over the past month, although they noted some decrease in higher-priced homes. Looking ahead, realtors expected home sales to increase, especially in the more expensive segment of the market. Realtors predicted that lower interest rates and a quick resolution of the Mideast crisis would boost buyer interest and sales in 1991.

Our telephone survey of home builders indicated that housing starts slowed more than usual in December. A majority blamed lower home sales for the slowdown. Builders indicated that many homeowners were remodeling and adding to their existing homes rather than building new ones. Few builders expected conditions to improve over the next three months.

Tourism

Hotels, motels and resorts throughout the District indicated that tourist activity had declined considerably compared with previous winters. Most respondents experienced declines in bookings, which they attributed to the downturn in the economy, bad weather for skiing, increases in fuel prices and the Mideast crisis. A majority expected tourist activity to worsen in coming months.

Finance

Financial institutions contacted by telephone indicated that real estate and commercial loan activity weakened in December and early January. A majority of institutions suggested that the slowness resulted from sluggish loan demand and not from more stringent credit criteria.

Lenders indicated that the prime rate and other interest rates would have to drop at least one percentage point further to boost loan demand. They noted that much of December's borrower traffic consisted of loan inquiries and business loan refinancings rather than new loan applications.

Other District contacts suggested that consumers may be suffering from financial stress. These contacts cited increases in auto repossessions and home foreclosures. Also, according to surveys conducted by several District newspapers, many pawnshops indicated that their loan activity was increasing.

State Budgets

Our discussions with state government budget forecasters indicated that all five District states and the District of Columbia were either experiencing or expecting revenue shortfalls. They blamed the shortfalls on their deteriorating economies, which they attributed to several factors including the Gulf crisis.

Serious revenue shortfalls were reported in Virginia, Maryland, North Carolina, and the District of Columbia. In these jurisdictions, most major categories of tax receipts either were declining or growing only sluggishly. South Carolina noted a modest shortfall while West Virginia's revenues were still considered adequate. Both of these states, however, expected lower revenues in the months ahead. Respondents said lower-than-expected revenues were only part of the problem. They also cited overly ambitious spending plans, federal and judicial spending mandates and rising health insurance costs.

State budget analysts were not encouraged by the outlook. A Maryland official expected improvement soon; most others were hesitant to forecast a turnaround in the near-term future.

Agriculture

According to farm analysts, conditions in agriculture were generally good as of mid-January. The condition of small grain crops planted last autumn was reported to be above average due to warmer-than-normal temperatures and abundant soil moisture. Feed and forage stocks appeared adequate and were expected to be more than sufficient to last the winter.

Our contacts suggested that the financial condition of District farmers remained strong, but some expressed concern that higher production costs may squeeze profit margins in the year ahead.

SIXTH DISTRICT - ATLANTA

Overview: A large majority of firms contacted around year end reported marginally lower or flat production, sales, or employment compared to late fall and a year ago. Retailers, with few exceptions, reported that real holiday sales fell below or only equalled last year's levels. While domestic sales are reported to be down by many contacts in diverse industries, several businesses report growing international sales. Continued widespread contraction in construction is reported to be causing construction-related manufacturing activity to weaken further. Banking contacts supported these interpretations with information that consumer loan demand and business capital spending are softening. Contacts report that the California freeze is raising fruit and vegetable prices, while an unseasonably warm winter in other areas has led to falling prices for natural gas.

Retail Sales: Retailers said that real sales had turned out weak compared to a year earlier, though most had expected this to happen. Contacts say that they planned inventory carefully, promoted and discounted items early, and finally moved remaining merchandise with further price cuts during the week before Christmas; that helped trigger an unusually large late sales surge. It appears that sales activity was not as poor in the western part of the District. Although sales of most big ticket items were reported to be weak everywhere, luxury items received a temporary boost in December from the special tax slated to begin in 1991. Florida restaurateurs and luxury resort operators report reduced business entertainment spending, and a "no frills" hotel franchiser says that business travelers in the Southeast are "trading down." Tourism, overall, is still strong but there are reports of softening domestic leisure travel to Florida. According to industry contacts, convention attendance in Atlanta, New Orleans, and Orlando has been record-setting.

Manufacturing: Producers in most industries report declining or flat domestic sales while reports on the strength of exports vary. Contacts reporting strong exports but flat domestic sales include a telecommunications components manufacturer in Atlanta, linerboard and pulp manufacturers with plants across the Southeast, a major regional aluminum can sheet producer, and a few makers of original equipment auto parts. Mobile home manufacturers in Florida, Georgia, and Mississippi report new or expected contracts to make homes for Russian immigrants in Israel, helping to offset weak domestic sales. Manufacturers who report weak domestic sales that are not being offset by growing exports include southern pine lumber producers for whom Iraq represented a major market before its August invasion of Kuwait. Lumber sales to LDCs in the Caribbean and Africa also are reported to be down because of the higher energy costs they are facing. A Georgia producer of carpets says that Saudi Arabia, the largest international market for the state's carpets, has stopped taking delivery and that insurance costs on shipments to the Middle East have become prohibitively high. A major supplier of inorganic industrial chemicals to domestic manufacturers of many industrial and consumer products reports significantly lower sales compared to a year ago. A plumbing fixture supplier serving Georgia and Tennessee and a Florida wall coatings manufacturer report lower sales in their domestic-only markets. In contrast, pen and pencil and cellular phone companies report healthy domestic and foreign sales.

Financial Services: Bankers indicate that business and consumer loan demand was weak in December compared to a year ago and attribute the weakness to the slackening economy and uncertainties associated with the Middle East crisis. Loan officers say that capital spending is shrinking or being delayed in several industries. Direct reports from businesses such as a hotel franchiser, a computer software firm, and a producer of office supplies confirm this information. Industrial engineering, accounting, and management consulting firms report a decline in their

businesses due to reduced capital spending by clients. However, one loan officer reported continued strength in loan demand by the health industry, and a Miami banker notes growing demand from firms exporting to South America.

Construction: . Most segments of construction activity across the region were down sharply at year-end from levels a year earlier and in previous months of 1990. In contrast to previous years, there was no initiation or acceleration of projects related to tax laws. Parts of Louisiana and Mississippi are reported to have more building activity than last year at this time, but these areas are expanding from depressed levels. A large building materials supplier, who has already cut his payroll by 15 percent, says that he is experiencing collection problems from hard-pressed contractors and that the remodeling business is flat. A home improvement company in Georgia also reports that December and early-January sales are down from preceding months.

Wages and Prices: A major Florida contractor cites a decline in prices of concrete and construction tools in response to construction's weakness. South Florida citrus and vegetable growers are reported to be temporarily reaping much higher prices as a consequence of the December freeze affecting Southern California crops. Trucking company contacts, a mobile home manufacturer, and a regional supplier of linens say their profits are falling because they are unable to pass on increased fuel costs. According to an industry contact, natural gas prices fell significantly in January because of unseasonably warm weather and excess supplies.

SEVENTH DISTRICT--CHICAGO

Summary. District economic activity slowed in December and early January, particularly as auto production fell. A consensus outlook of business economists in the District called for a mild recession nationally to end by the second quarter, followed by a sluggish recovery that is held back by weak industrial production. District retailers indicated that consumer spending over the holiday season was somewhat stronger than the national average. Auto sales and production remained weak in December and early January, and the impact of slowing auto production is beginning to spread to other manufacturers. Outside the auto industry, several capital goods manufacturers report recent weakness in sales and orders. Export growth continued, although several contacts with important exporting sectors expressed concern about continued strength. Construction spending continues on existing projects, while expectations for 1991 activity continue to be weak. Loan demand in the District has softened. Agricultural exports fell sharply in recent months.

Outlook for the National Economy. Business economists from around the District attending a mid-December conference at the Bank generally anticipated sluggish growth in 1991. The consensus outlook of 25 forecasts showed real GNP rising only 0.4 percent in 1991. The quarterly pattern indicated by the consensus showed real GNP declining in the fourth quarter of 1990 and the first quarter of 1991. A slow recovery was expected over the remainder of 1991, as declines in industrial production extended into the second quarter. Citing weakening cash flow in the nonfinancial business and farm sectors, several capital goods producers projected absolute declines in expenditures for their respective product categories (including office and computer equipment). Consumer spending was expected to expand in the second quarter at a slow pace as auto sales make a moderate rebound. In the weeks after the meeting, reports by participants suggested that many revised forecasts downward as new data were released, but little change arose in the expected quarterly pattern of economic activity.

Consumer Spending. Retail sales activity generally softened through most of the fourth quarter, but picked up toward the end of the holiday season. Most contacts report that consumer spending in the District was still somewhat stronger than the nation on average. Several retailers reported that holiday sales were basically flat (in nominal dollars) with last year, while District sales increased slightly. Some

contacts spoke of heavier-than-usual discounting toward the end of the year, which may have boosted some retailers' sales at the expense of earnings. Contacts generally noted increased consumer cost-consciousness and a shift towards practicality. The best sales performances typically were reported by discount retailers. Several contacts reaffirmed the weakness in the Detroit area, although one analyst stated that the warehouse club/discount format performed well in Detroit in December, showing good volume increases. While most contacts reported little change in the mix of sales between credit and cash, many reported rising delinquency rates on utilized credit.

Sales expectations for the new year are mixed, and contacts universally cited the Middle East situation as a yet-to-be resolved uncertainty. Most contacts related a belief that the consumer has been postponing discretionary purchases. However, opinions were mixed about the degree to which consumer confidence will return, should a peaceful resolution to the Middle East conflict be reached. Several business analysts in the District stated that the perception of difficulty in the banking industry has also impacted consumer confidence. Retail contacts generally indicated that orders to manufacturers are running about even with those placed at this time last year. Increased financial difficulties and inventory building in several sectors, however, may constrain total order activity in the early part of the year.

Auto Industry. The auto production slowdown continued in December and into the first weeks of 1991, as industry sales remained weak nationally and consumer confidence remained at recessionary levels. While Big Three automakers attending the Bank's December meeting expect 1991 vehicle sales to be roughly 7 percent lower than in 1990, sales rates (seasonally adjusted) are expected to improve each quarter of the year. Fleet sales are expected to continue to grow in importance, lowering inventory requirements for a given sales level and holding back a production rebound. Vehicle rental and leasing activity are growing more rapidly than sales to individuals. Although several dealers expressed optimism about the prospects of the "nearly-new" car market created by the quicker turnover of auto fleets, auto producers report concern that new car sales and production will be adversely affected. Auto suppliers report being impacted by slower auto production and by volatility in production schedules. Since employees of many suppliers to Big Three automakers do not have the income guarantees won by

members of the United Auto Workers, softness in auto-related sectors could curb District personal income and spending growth in the near future.

Manufacturing Activity. Manufacturing activity has experienced an increasing number of weakening sectors besides the auto industry, while some industries remain healthy. Overall, order book quality seems increasingly subject to the same uncertainty that is slowing consumer spending, with many contacts reporting that capital spending decisions have become contingent on outcomes in the Middle East. A major producer of heavy equipment reported that sales declined sharply in December and early January (from the year-earlier periods), while new orders have fallen off even more dramatically than sales. The slowdown in auto production has begun to impact the previously stable steel industry. A large District steel producer reported that the slowdown contributed to a sharp decline in its operating rate in late December and early January. A major supplier to the electronics industry reported that component sales growth was better than expected in December. This contact expected continued growth in 1991, but at roughly half the rate in recent years. An economist for an electric utility stated that power sales to non-automotive industrial customers in Michigan increased in December.

Trade Activity. Several District contacts reported that expectations have weakened for export growth continuing at recent rates, although exports still provide some of their strongest markets. Citing slower growth in domestic demand in Canada, much of Western Europe, and parts of Asia, economists with two of the largest exporting firms in the District recently lowered their forecasts for 1991 export growth. Another large District capital goods producer stated that export opportunities are still being developed, and that export orders are holding up reasonably well. However, this contact expressed concern about the potentially adverse impact on sales growth from slowing growth in several European economies as well as political uncertainty in the Soviet Union. Steel imports actually increased in the fourth quarter, although a large District steel producer stated that the increase may reflect, in part, inventory building prior to a possible strike in late January. Citing the crisis in the Middle East, one large District exporting manufacturer recently suspended international travel of its employees, and ordered all U.S. citizens working abroad to return home.

Construction. Commercial construction in the District is widely expected to be weak this year, while spending for schools, highways, and other public construction is expected to take up some of the slack. A large District producer of building materials stated that projects underway are being completed, but new projects are well below levels reached at the end of 1989. A cement producer projected a double-digit decline in the firm's shipments in 1991. Cement industry shipments in 1990 (through October) showed that relative strength in the District has disappeared, with shipments growth in the Great Lakes region now running about equal with that for the nation as a whole (on a year-to-date basis). A supplier of materials to home builders in the Chicago area reported that business for many of its customers has slowed dramatically, although sales growth for consumer do-it-yourself projects was holding up well even through the Christmas season.

Financial Institutions. Several District financial institutions are experiencing weak loan demand from many sectors, although some contacts noted a slight increase in credit card usage last quarter. Several bankers reported continued weak growth in commercial real estate and industrial loans, which was attributed mostly to an unwillingness to borrow. One large bank reported increases in services fees, but basically unchanged lending policy. A savings and loan analyst noted some growth in home mortgage lending when mortgage rates were below 9.5 percent, but most of that demand is for refinancing. One large bank's credit card volume increased in the fourth quarter, with half of the gain due to increased usage by existing accounts. This lender also reported no increase in consumer delinquency rates (through November), although delinquency in home mortgage lending had increased slightly.

Agriculture. Corn and soybean exports have fallen off sharply in recent months. From January through August of 1990, the combined U.S. export tonnage of corn and soybeans held nearly 13 percent above the year-earlier level. But from September through December, the combined export tonnage was off a third from the year-earlier pace and the lowest for that period in at least 16 years. Several factors have contributed to the sharper-than-expected downturn, including the emerging trade problems facing the USSR, bumper harvests elsewhere in the world, and various disruptions related to the Mideast situation. Most analysts believe that the export pace will pickup in the months ahead but remain short of the year-earlier level.

EIGHTH DISTRICT - ST. LOUIS

Summary

District economic conditions continue to deteriorate. Employment and output are declining in the durables manufacturing sector, while the nondurables sector is relatively stable. Real consumer spending during the holidays was down sharply from a year ago. Total loans outstanding have risen slightly at large District banks. Real estate markets continue to slump. Agricultural and natural resource conditions are mixed.

Consumer Spending

District retailers report that nominal sales during the 1990 holiday season ranged from slightly higher to 10 percent lower than in the previous year. In addition to consumers' concerns about recession and war, unseasonably mild weather reportedly dampened sales of winter apparel early in the season, while ice storms in some areas hampered sales the week before Christmas. Respondents reported that inventories were near desired levels, however, as most retailers had planned for sluggish sales. When contacts were asked whether more price discounting was used than in previous years, responses were mixed. The outlook for the first quarter of 1991 varied from bleak to optimistic, particularly if the Persian Gulf conflict is resolved quickly. Contacts report new car sales continue to be well below year-earlier levels, except for imported luxury cars, which registered strong December sales as consumers sought to avoid the new federal taxes on expensive and "gas-guzzling" cars.

Manufacturing

Many producers of durable goods, including firms producing heating and cooling equipment, industrial machinery, electrical wiring, refrigerators and furniture, have cut production recently; many expect additional cuts in the first quarter. The federal government's cancellation of a military jet contract will result in the elimination of 3,000 to 5,000 jobs at one Missouri defense contractor. This follows layoffs of roughly 4,000 workers last year by the same contractor. Most of the region's motor vehicle plants have had intermittent layoffs, although plants making sports/utility vehicles and minivans have scheduled overtime in recent weeks. Several vehicle-related factories have had declining orders, including two large tire plants, which had sizable layoffs. Overall, production of nondurables has been flat; however, food processing activity has expanded. Growth in poultry processing, in particular, has been fueled by export sales and sales of processed convenience dinners.

State Government Finance

Slowing economic growth in Missouri and Tennessee has caused state government revenues to fall short of projected levels. Both states expect revenues in the current fiscal year to be roughly 2 percent less than originally projected. Both states also have limited spending to avoid a budget deficit. Revenues are expected to show no real growth through 1991.

Construction and Real Estate

Residential real estate markets across the District continue to slump, although many contacts believe a turnaround will occur by the end of the first quarter. A lack of consumer confidence is cited as the major reason for slow sales, despite recent declines in interest rates

and home prices. Recent layoffs in St. Louis are expected to depress that housing market further. Commercial real estate markets, except for distribution warehouse space in Memphis, also are weak. To adjust to the slower pace of residential and commercial construction, many developers and suppliers are broadening product lines. One Memphis contact reported, for example, that major commercial developers have shifted their focus from building office and retail centers to leasing, property management and marketing of services for business owners.

Banking and Credit

Total loans on the books of 11 of the District's largest banks rose 2 percent from the end of October through year-end, after showing no growth in the two months previous. Real estate and consumer lending grew over the period, while commercial and industrial (C&I) lending continued to shrink. Contacts expect no significant uptick in C&I or commercial real estate lending, at least until the third quarter, because of weak demand and tightened credit standards. Preliminary estimates by many banks indicate improved profit margins by the fourth quarter. Net interest margins were buoyed by declines in interest rates, which lowered funding costs.

Agriculture and Natural Resources

Heavy rains and melting snow have caused flooding in some areas and raised river levels throughout the District, but barge traffic has not been disrupted significantly. Southern pine lumber mills report that recent orders and shipments have fallen below year-ago levels and inventories are up. District coal production is running about 4.4 percent ahead of last year. Agricultural contacts report low or falling prices for wheat, soybeans, broilers and hogs, but continued strong returns for beef cattle.

NINTH DISTRICT - MINNEAPOLIS

Ninth District economic conditions have been uneven. Labor market conditions have been mixed. General merchandise sales growth has been slow to moderate. Automobile sales have declined from their year-ago levels. Housing activity has rebounded but has remained depressed from its levels in the late 80s. Conditions in construction and manufacturing have been mixed. Resource-related industries have been doing fairly well. Many respondents expressed concern about the economic effects of the situation in the Persian Gulf.

Employment, Wages, and Prices

Labor market conditions have been mixed in the district. Minnesota's unemployment rate was 3.8 percent in November, down from 4.2 percent in October, but up from 3.6 percent in November 1989. Unemployment rates in November were higher than a year earlier in Montana and the Upper Peninsula, but lower in North and South Dakota and western Wisconsin. Employment levels in the district in November were generally higher than their year-ago levels. In Minnesota, for example, the number of people employed in November was 1.5 percent higher than in November 1989. There are some signs of weakness, however. The help wanted index in Minnesota in November was 26.3 percent lower than in November 1989. A nationwide survey of employers reports that in the Minneapolis - St. Paul metropolitan area 8 percent of employers intended to add employees and 13 percent intended to cut back their employment levels. The survey also reports that the metropolitan figures were slightly worse than the national average. Wage and price increases have remained moderate.

Consumer Spending

District retailers of general merchandise report slow to moderate sales growth. One major retailer reports that December sales in comparable stores were 2.4 percent higher than in December 1989. Another retailer reports that while national sales were only 1.5 percent higher in December than a year ago, sales in the Upper Midwest region of the country were 4 percent higher than a year ago. Retailers comments generally reflect disappointing sales relative to their expectations. One retailer reports that discounting of prices was broader and deeper than expected. Retailers generally expressed a great deal of uncertainty about the outlook for the next few months, due in part to concerns about the conflict in the Middle East.

New car sales in the district in December were generally lower than a year ago. Dealers report sales declines from last December ranging from 6 percent to 30 percent. Reports on truck sales in December relative to a year ago range from unchanged to a decline of 14 percent. Dealers' reports on car and truck inventory levels range from moderate to high.

Housing starts have rebounded from their depressed levels in 1990, but are still sharply lower than their levels two years ago. The number of new housing permits issued in Minnesota in November was 7 percent higher than in November 1989, but 25 percent lower than in November 1988. Existing home sales in the Minneapolis - St. Paul metropolitan area have recently shown signs of slowing. In November they fell by 9.4 percent from November 1989.

Tourist activity has been moderately good. Ski resorts in Montana and parts of Wisconsin report fairly good conditions, while those in the Upper Peninsula of Michigan report that a lack of snow has slowed business. However, general tourist activity in the Upper Peninsula of Michigan has been fairly good. The number of crossings over the Mackinac Bridge into the Peninsula in

November was 7.2 percent higher than the previous record levels of November 1989. The number of visitors to Yellowstone in 1990 was 6.1 percent higher than in 1989.

Construction and Manufacturing

Conditions in the district's construction industry have been mixed. The overhang of office space in the Minneapolis - St. Paul metropolitan area is expected to depress construction activity in the area. The value of office buildings in downtown Minneapolis has declined recently, causing an expected erosion of about 10 percent in the city's commercial tax base.

Conditions in the district's manufacturing industries have been mixed lately. An index of economic indicators shows that economic activity in the Minneapolis - St. Paul metropolitan area fell in the third quarter from the second quarter, but was higher than in the third quarter of 1989. Computer and electronics industries in the district have continued to be in poor shape, but aircraft industry suppliers report rapid sales growth. Several respondents report that export demand has continued to be strong.

Resource-Related Industries

The district's resource-related industries have been doing fairly well. Ranchers in the district report that 1990 was an excellent year. Farmers generally report that crop yields in 1990 were fairly good. However, prices for farm products have generally declined. An index of prices received by farmers was 9 percent lower in November than in November 1989. Farmland values in the district rose approximately 4 percent during 1990. Precipitation in the district this winter has generally been below normal, which could adversely affect crop yields in 1991. Conditions in the district's mining industry have been fairly good. Iron ore production in Minnesota in 1990 was 5.1 percent higher than in 1989.

TENTH DISTRICT - KANSAS CITY

Overview. Growth in the Tenth District economy has slowed in recent weeks, but is apparently still positive. Farm income prospects have dimmed somewhat while growth in the number of operating drilling rigs has leveled off. A disappointing Christmas season failed to boost sluggish retail sales, prompting both retailers and manufacturers to trim inventories. Mortgage demand and housing starts both continue to fall, despite lower mortgage interest rates. Loan demand at commercial banks continues to drop as well, due mainly to sluggish demand for commercial real estate loans and residential construction loans.

Retail Sales. Most district retailers report worsening sales over the past three months, accentuated by disappointing results from the Christmas season. Sales during the holiday season were generally flat and often worse than expected, although discounters enjoyed slight gains. Retailers report weak sales in most merchandise categories other than clothing and expect further weakness in the coming months. Most respondents have been trimming inventories and expect to continue this trend. Product prices have leveled off and are expected to remain flat or increase only slightly in the coming months. New auto sales have fallen in most district states over the last month and are expected to be sluggish again this year. Financing is generally available for inventories and for potential buyers, although some dealers report tightening credit standards. Most automobile dealers are trimming inventories.

Manufacturing. Purchasing agents report stable to slightly higher input prices over the past three months, leaving prices moderately higher than a year ago. Expectations about future prices are mixed, in part due to

uncertainty about the Persian Gulf crisis. Materials availability and lead times pose no problems for most manufacturers. Most firms continue to trim inventories. A bright spot in the manufacturing picture is strong exports, thanks both to the weaker U.S. dollar and to healthy economic growth abroad, especially in Europe and South America. One manufacturer of steel pipe and tubes noted that a sharp drop in penetration of the U.S. market by Japan, Europe, and Canada leaves more room for domestic producers.

Energy. Oil prices declined in December due to abundant supplies of crude oil and expectations of a peaceful settlement in the Gulf crisis. Uncertainty about the outcome of the crisis and its impact on world crude oil supplies continues to moderate gains in district drilling activity. The average number of operating drilling rigs in district states rose from 336 in November to 341 in December, only slightly higher than a year ago.

Housing Activity and Finance. Housing starts have declined in recent weeks, sinking below year-ago levels in most areas of the district. Most builders expect starts to fall on balance over the course of the year, even though new home sales and prices should generally remain stable. Sales of building materials are down substantially from both three months and a year ago, prompting suppliers to predict 1991 will be a "tough year." Respondents from thrifts report moderate outflows of deposits over the past month and expect little change in deposit flows over the next three months. Mortgage demand has dipped below seasonal norms. Mortgage rates have been falling, and most respondents expect rates to continue to fall slightly over the first quarter of 1991.

Banking. Most commercial bankers report loan demand decreased last month. In most cases, the decrease reflects lower demand for commercial real

estate loans and residential construction loans. Results for commercial, consumer, and home mortgage loans were mixed, while agricultural loan demand increased somewhat. Most bankers report no change in credit standards over the last month. While most respondents have not changed their prime rate or consumer lending rates, they expect to reduce both in the near future. Total deposits increased at most banks last month. Demand deposits were up, and NOW accounts and money market deposit accounts were stable to higher. Changes in small time deposits varied widely, while large certificates of deposits generally fell.

Agriculture. District farmers and their lenders approach 1991 with caution. The winter wheat crop is in good to excellent condition in most of the district, as extensive crop damage was avoided during the recent period of cold weather. The crop remains vulnerable to winter kill, however, due to low soil moisture and the absence of a protective blanket of snow. A sharp drop in crop prices since mid-1990, a cutback in government payments under the new farm bill, and higher fuel and agricultural chemical prices have lowered prospects for farm income. As a result, spending on new farm equipment fell sharply in the last quarter of 1990, and bankers expect sluggish spending in the year ahead. Dimmer prospects for farm income have also slowed sales of farm real estate in the district. Still, concerns about the health of the national economy and about lower farm incomes have affected spending in district rural communities only slightly. Retail sales in most rural communities remain solid.

ELEVENTH DISTRICT--DALLAS

Output in the District has been flat to slightly down. The manufacturing sector continues to decline while growth in the service sector has slowed. Retailers report weak holiday sales. Auto sales have improved. Construction activity has increased moderately. Oil production has risen due to increased production from existing wells and new drilling. Local government revenues are decreasing while demand for government services is increasing. The crop harvest increased this year, but production costs hurt profit margins.

Manufacturing orders continue to be weak although there is little evidence of any sharp decline. Inventories remain lean. Many respondents say that their export orders continue to be healthy while domestic orders have declined. Many respondents expect a rebound in orders in the second half of this year. Orders to chemical producers have recently declined, after a surge following the Kuwait invasion. Continued high production of chemicals has built inventories to desired levels and firms are now reducing output in response to the declining demand. Petroleum refiners also note declining orders and production. District manufacturers tied to the construction sector (stone, clay and glass, lumber and wood products, and fabricated metals) say that orders from outside the District have declined sharply, but District orders are unchanged or growing. Many respondents feel that much of the recent weakness in construction is weather-related. Although orders for apparel products is flat, sales of lower priced basic lines have increased. Producers of electronics say that orders generally have been flat, although one producer of communication electronics says that sales of several new

products have been robust. Orders for primary metal producers are declining. Most respondents in the paper industry say sales have been flat. Sales of oil field equipment continue to increase and many manufacturers are adding capacity.

Growth in the service sector has weakened since the last survey. Demand is strong at agencies which supply temporary workers. Law firms note that overall demand has been flat. Declining business conditions have slowed demand growth for consulting firms. Accounting firms note some increased demand for cost-saving services such as tax advice and internal audits. Airline industry respondents note a slight pick up in traffic due to price discounting.

Retail sales are slightly above last year although retailers indicate that holiday sales were disappointing. District sales are modestly outperforming the nation's, particularly in Houston. Increased competition is generating heavy price discounting which has squeezed margins. Some retailers indicate that inventories are above desired levels.

District auto sales have increased. Dallas-Fort Worth area auto sales were flat in November, holding year-to-date sales at last year's level. Houston area sales were strong in November. Houston is now expecting to end 1990 with a modest increase in year over year sales.

Energy extraction has increased in the past several months. Higher oil prices have increased both drilling for oil and production from existing wells. Large supplies of natural gas and unseasonably warm weather, however, have suppressed natural gas prices. Respondents say that current conditions in the natural gas market have caused declines in drilling for gas. The long-

term outlook for gas has improved, however, and respondents say that drilling for gas should improve this year. Projections for growth in the rig count in 1991 vary from zero to a 15 percent increase.

Construction has increased modestly in recent months with much of the activity centered in Houston and South Texas. Highway construction has recently increased but builders expect future declines in Texas as federal and state funding shrinks. Despite recent increases in residential construction, respondents generally have become more negative about the outlook. District residential builders note that decreased lending by banks and the national housing recession are major obstacles to significant growth in their industry.

Local governments say revenues are declining due to lower sales tax collections. Increased demands for health care, law enforcement and improved waste water treatment facilities are straining already tight budgets. As a cost-cutting measure, several local governments have begun efforts to contract out services such as sanitation and cleaning.

The District agricultural harvest is virtually complete. Some crops were lightly damaged by freezing temperatures in December. The December livestock and livestock products index increased 8 percent from a year ago and 2 percent from November. Texas producers are averaging higher prices for beef cattle and calves. December crop prices were 2 percent below a year ago and 1 percent below November. Lower prices for corn, cottonseed and wheat offset higher prices for cotton, all hay, peanuts, sorghum and soybeans.

TWELFTH DISTRICT -- SAN FRANCISCO

Summary

Economic conditions in the West are reported to be softening further. Slower growth is bringing continued moderation in wage and price increases throughout the District. Holiday retail sales were mixed in the West, but, generally, were above low pre-holiday expectations. Manufacturing activity continues to slow across much of the West. Agriculture and resource-related industries in the District have been hit hard by a combination of low prices and weather related difficulties. Construction and real estate activity continues to be hampered by an abundance of vacant office space and difficulty in obtaining financing. Western financial institutions report mixed conditions, but many areas note a weakening in loan demand.

Business Sentiment

Western business leaders' expectations about future economic growth deteriorated slightly in January. Eighty-one percent now foresee a national recession in the next twelve months, compared with 75 percent in November and 40 percent in September. An increasing number of business leaders see this weak economic growth leading to a lessening of inflationary pressures. Almost half now project lower inflation during the coming year. Respondents were less optimistic about foreign trade, with only 29 percent expecting a pick-up compared to 44 percent in November.

Wages and Prices

Wage and price increases continue to moderate throughout the Twelfth District. Most retailers reported significant discounting during the holiday season in the face of a softening economy. Abundant grain and feed crops are pushing down prices for many agricultural commodities, like wheat. Prices for citrus fruits, especially navel oranges, and some vegetables have risen significantly as a result of the freeze in California. Wage demands are reported to be moderating as job security has become a more important concern. In Seattle, manufacturing wages are reported up 5 percent

from last year, bolstered by gains in aerospace.

Retail Trade and Services

Retail trade activity is mixed in much of the West. Holiday sales were flat to slightly down from last year. However, according to most reports, this performance was not too disappointing considering the economic climate. Southern California registered weak sales, while retailers in other areas of California reported slightly stronger sales. In Oregon and Washington, sales were flat despite severe weather that slowed holiday activity. Sales were slightly above year-earlier levels in Idaho and Utah, and up a strong 9 percent or more in Hawaii. Most retailers entered the holiday season with low inventories, and report that business plans for 1991 will continue to be conservative. One retailer reports that sales were up sharply in the first week of January.

Classified advertising volume continues to shrink for newspapers in California, but not as sharply as in other areas of the country. One report indicated that total classified advertising volume was down 3 percent from a year ago in California.

Manufacturing

Manufacturing activity in the West continues to slow. Defense-related aerospace activity remains weak, and commercial aircraft manufacturing is expected to slow. Aluminum and steel markets also are reported to be soft. Manufacturing export volume is reported to have improved slightly, while imports have weakened.

Agriculture and Resource-Related Industries

Agriculture is facing difficult conditions as lower prices and weather conditions cloud the outlook. Large grain and feed crops are pushing down prices for many crops. In Idaho, the price of farmland is reported to have fallen in the face of sharply lower prices for wheat. The freeze in California wiped out the Navel Orange crop and damaged other crops and trees. The freeze is expected to reduce California's \$17.5 billion total farm revenue by \$1 billion. In addition to crop

losses, the freeze also caused large layoffs in food processing plants in California's central valley. Continued drought conditions also are reported to be causing major problems for California farmers. Lack of grazing land is reportedly forcing ranchers to liquidate their herds or move them to feedlots. Despite this increase in the beef supply, livestock prices remain high. Agricultural exports continue to expand, but there are concerns that the California freeze will hurt citrus producers' ability to move into the newly opened Japanese market.

Forest product industries remain depressed. Weak demand has caused prices for paper, containerboard, and plywood to fall. These lower prices coupled with high log prices have squeezed profits and caused many mills to close in the Northwest.

Construction and Real Estate

Construction activity in most areas of the West is weak as a result of an abundance of office space in most of the major cities. Continued difficulty in obtaining financing for new construction projects also is blamed for the slowdown in activity. Reports from Los Angeles continue to cite high vacancy rates for downtown office space, and more space is coming on line. Commercial building in Seattle is described as lackluster. There is reported to be a substantial amount of new space yet to be absorbed in Seattle. Both residential and commercial activity remain relatively solid in Boise and Salt Lake City as well as in Sacramento, Bakersfield, and other parts of California's central valley.

Real estate sales and prices remain weak throughout much of the West. In California, sales have stabilized in the past few months, with prices near their year-earlier levels. Most of the residential activity continues to be in the lower-priced end of the market. In Seattle, median home prices peaked in mid-1990 and are reported down 15 percent from that peak.

Financial Sector

Conditions in Twelfth District financial institutions are mixed, with solid conditions reported in the inter-mountain states and continued softening in coastal areas. Loan demand is reported weak in

Southern California, Oregon, and Washington. One report notes that auto loan demand has softened, while another report indicates that consumer credit card balances did not increase as much as usual this holiday season.