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Summary of Commentary on \_\_\_\_\_

# **Current Economic Conditions**

by Federal Reserve District

June 1996

**SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS  
BY FEDERAL RESERVE DISTRICTS**

**JUNE 1996**

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**SUMMARY\***

Reports from the twelve Federal Reserve Districts suggest economic activity continued to advance at a moderate pace in May and early June. Nearly all districts report expanding activity, and several indicate the pace of growth accelerated recently. The retail and service industries generally strengthened, and manufacturing activity improved in several districts. Residential and commercial construction activity also picked up in most districts, although wet weather hampered homebuilding in some areas. Loan demand increased in most districts, despite a decline in mortgage lending. In the natural resource industries, agriculture was hurt in several districts by unfavorable weather and low cattle prices, while energy activity increased in regions producing oil and natural gas.

Several districts note rising prices for some raw and intermediate products, especially building materials, petroleum products, and grain. Evidence of rising prices for retail products, however, was much less widespread. Most districts continued to report tight labor markets for both entry-level and skilled workers, although indications of rising wages remained scattered.

**RETAIL**

Retail sales strengthened in nearly all districts, with sales generally exceeding year-ago levels. The only exceptions were the Boston and New York districts. In the Boston district, retailers indicated that recent sales were disappointing, especially in off-price discount stores.

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but they were generally optimistic about sales prospects during the remainder of the year. In the New York district, sales slowed slightly in early June after exceeding expectations in May.

Recent sales gains followed normal seasonal patterns in most districts. Retailers in the New York, Philadelphia, Cleveland, Atlanta, Kansas City, and Dallas districts report strong sales of seasonal items such as air conditioners, men's and women's apparel, and lawn and garden products. In the Cleveland and Chicago districts, however, unusually wet weather slowed sales of home improvement products and other seasonal items.

Automobile sales remained strong in most districts. Dealers in the Philadelphia, Cleveland, and St. Louis districts attribute part of the recent sales strength to various sales incentive programs. Some popular models were in short supply in the Cleveland and Kansas City districts. The Philadelphia district, however, reports weak sales of heavy trucks.

## **MANUFACTURING**

Manufacturing activity improved in several regions, while pockets of weakness remained in some districts. Districts reporting generally improved manufacturing activity include Boston, New York, Philadelphia, Richmond, Chicago, Minneapolis, Kansas City, Dallas, and San Francisco. Reports from the Cleveland, Atlanta, and St. Louis districts indicate manufacturing activity was uneven or flat.

Activity improved in a wide range of industries. Both consumer and capital-goods industries improved in the Boston district. In the Richmond, Chicago, and San Francisco districts, industrial machine and tool manufacturing strengthened. Construction-related industries were strong in the Dallas and San Francisco districts. Conditions in the oil field equipment industry improved in the Dallas district.

Some districts report weak spots in manufacturing activity, however. In the Boston district, demand for hospital equipment was weak, reportedly due to lower cost health care plans. The heavy truck and construction equipment industries remained soft in the Cleveland and Chicago districts. In the Dallas district, the semiconductor industry remained weak, due to a slump in demand for computers and related products.

### **SERVICES**

Service activity continued to expand in districts reporting on this sector. In the Boston district, demand for temporary workers continued to strengthen. Service producers in the Richmond district indicate that employment rose in May, although revenues declined slightly. The San Francisco district reports strong demand for computer-related services, telecommunications, and long-distance trucking.

The tourism industry remained robust. The New York district reports hotel occupancy in New York City remained at a 16-year high. In the Richmond district, tourism activity picked up in May despite wet weather. The Atlanta district reports strong gains in attendance at Florida hotels and theme parks and rising gambling revenues in Mississippi. Also, the approaching Olympic Games have apparently boosted passenger traffic at Atlanta's Hartsfield International Airport. In the Minneapolis district, the tourism industry holds optimistic expectations for the summer, even though the season's start was delayed by cold, wet weather.

### **CONSTRUCTION AND REAL ESTATE**

Residential real estate activity generally strengthened in most districts, including New York, Philadelphia, Atlanta, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco. Signs of sluggishness emerged in some districts, however. Housing sales slowed in some parts

of the Boston and New York districts. Builders in the Richmond district report declining buyer interest in new homes, although housing sales rose. In the Chicago district, wet weather slowed homebuilding and sales, but builders expected a stronger third quarter.

Commercial real estate activity continued to improve in most districts. The Philadelphia, Richmond, and Atlanta districts report declining office vacancy rates, higher rents, and gains in commercial construction activity. The Minneapolis district reports solid gains in contracts for large projects. In the Dallas district, the tightest supply of suburban office space in a decade was pushing up rents. A few districts report a weakening in commercial activity. The New York district reports office vacancy rates edged up in New York City in May. In the St. Louis district, commercial construction slowed in some areas of Tennessee and Arkansas.

## **BANKING AND FINANCE**

Overall loan demand rose in most districts, although demand for commercial loans and consumer loans varied among the districts. Demand for commercial and industrial loans was strong in the New York, Chicago, Kansas City, Dallas, and San Francisco districts, and was flat to down slightly in the Philadelphia, Cleveland, Richmond, Atlanta, and St. Louis districts. Demand for consumer loans was strong in the Cleveland, Richmond, Atlanta, Chicago, Kansas City, and Dallas districts, and flat to down slightly in the New York, Philadelphia, St. Louis, and San Francisco districts. The Cleveland and Chicago districts report intense competition among lenders. Mortgage lending and refinancing declined in most districts. In the Boston district, assets managed and employment at investment management firms strengthened.

## **AGRICULTURE AND RESOURCE-RELATED INDUSTRIES**

Agriculture was hurt in several districts by unfavorable weather and low cattle prices. Wet weather delayed the planting of spring crops and slowed crop development in the Cleveland, Chicago, St. Louis, Minneapolis, and Kansas City districts. The Cleveland and Chicago districts report that more favorable weather recently enabled corn and soybean planting to progress. Recent rains improved crop conditions in some parts of the Richmond district. The wet weather arrived too late in the Kansas City district, however, to avert an expected sharp decline in winter wheat production caused by drought earlier in the year. In the Dallas district, drought sharply reduced the expected size of the winter wheat crop and trimmed pasture and forage supplies. The St. Louis, Minneapolis, Kansas City, and San Francisco districts report unfavorable conditions in the livestock industry, due to low cattle prices and high feed costs.

Energy activity improved somewhat in the Minneapolis, Kansas City, and Dallas districts, despite declining energy prices. The Minneapolis district reports stronger iron mining activity and mixed conditions in the forest products industry.

## **PRICES AND WAGES**

Prices advanced for some raw and intermediate materials in several districts, especially for building materials, petroleum-based products, and agricultural commodities. Evidence of rising prices for finished products and at the retail level was less widespread. The Boston, Kansas City, and Dallas districts report higher prices for building materials, including lumber. Prices for packaging materials, some plastics, machinery, and steel were up in the Atlanta district. Higher wheat prices pushed up flour prices in the Minneapolis district, but otherwise had little effect on retail food prices. Manufacturers in the Boston and Richmond districts report



rising product prices, but flat to slightly lower materials prices. In the St. Louis district, some manufacturers report difficulty in raising product prices due to highly competitive markets. Retail prices held steady in the Boston, St. Louis, and Kansas City districts and rose more slowly in May than in April in the Richmond district. Retailers in the New York district, however, indicated that a decline in price discounting was boosting effective retail prices.

Most districts continued to report tight labor markets for both entry-level and skilled workers. The Cleveland, Atlanta, St. Louis, and Kansas City districts report a tight market for retail workers. In the Boston and Chicago districts, the number of temporary workers shifting to permanent assignments was increasing. Markets for skilled laborers remained tight in the Chicago, St. Louis, Minneapolis and Kansas City districts. The Boston district reports that a tight local labor market has prompted area businesses to recruit professional workers from other parts of the country.

Reports of rising wages are scattered, despite widespread tightness in labor markets. The Boston district reports rising wages in manufacturing. In the St. Louis district, some fast-food establishments offer wages above the minimum wage and include a signing bonus. The approaching Olympic Games were pushing up entry-level wages in the Atlanta district.

## FIRST DISTRICT - BOSTON

The First District economy expanded moderately in April and May. Manufacturers generally report solid growth, residential real estate had a strong first quarter, and temporary employment firms and money management businesses continue to grow. By exception, retailers report disappointing sales, citing continued upheaval in the region's retail sector. Input prices are mostly stable, while some manufacturers are raising selling prices slightly.

Retail

Many retail contacts in the First District express disappointment with April and early May sales growth, which ranged from 22 percent declines to 7 percent increases compared with year-earlier levels. Shopper traffic was particularly slow in off-price discount chains. The exceptions were a retailer of home furnishings with double-digit sales growth in April and May, and a hardware chain reporting record-breaking sales in late May, which they attribute to the arrival of summer weather. Most retail respondents are optimistic about the economy for the second half of 1996, anticipating sales growth ranging from flat to 15 percent over previous year levels. Off-price discount retailers note, however, that fierce competition is likely to force more companies into bankruptcy.

Most vendor and retail prices remain stable; an exception is lumber prices, which have risen steeply in the last six weeks. Gross margins typically are holding or improved, while profits vary greatly. Contacts are satisfied with their inventory levels. Only one respondent reports major increases in capital spending and employment for this year or the next.

Manufacturing

Two-thirds of the First District manufacturers contacted report solid sales gains relative to a year ago. Areas of improvement include consumer

durables and nondurables, as well as a broad variety of capital goods. Companies tied to the automotive industry expect favorable conditions to last at least through 1997. By exception, demand for hospital equipment continues to be held down by managed care, and conditions in the paper industry are weaker than a year ago. Contacts report that European markets, notably Germany, remain sluggish. Other than Latin America, sales to developing countries are said to be growing (although sometimes from a low base).

During 1995, paper users had been accumulating stocks aggressively in anticipation of rising prices; these holdings have been reduced, and one contact says further declines are warranted. Most other manufacturers believe their inventory levels are appropriate, although inventory/sales ratios continue to adjust to structural changes. For example, one manufacturer of consumer durables indicates a need for higher stocks of finished goods because retailers are reluctant to hold inventories in advance of the holiday season.

Over half of the contacts are achieving small increases in selling prices, while most report that prices of raw materials are flat to down. The prices of paper and plastics, in particular, have fallen from year-ago levels. By contrast, prices of foam, polyester yarns, glues, and some metals are said to be creeping up.

Almost half the sample report increased employment over the past year. Low rates of local unemployment are causing some firms to recruit professionals from other parts of the country. Wages and salaries are said to be rising in the range of 2 to 5 percent.

#### Temporary Employment Firms

Demand for temporary services remained strong over the first half of 1996. Information technology continues to lead the other sectors, but contacts report modest demand-driven increases in wages in most fields, especially for highly skilled workers. Industry sources note a renewed interest in "temp-to-perm"

placements, in which companies hire a worker through an agency for a trial period before making a permanent employment offer.

#### Residential Real Estate

Contacts report that the residential real estate market was quite strong in the first quarter of the year, but have mixed views as to developments in the last two months. Houses in eastern Massachusetts, Maine, and Vermont are reported to be selling at a rate well above year-ago levels, with the growth in eastern Massachusetts and Maine expected to continue at least through the end of the summer. Sales in Rhode Island, however, have slowed since the flurry of activity in the spring. Activity in western Massachusetts and Connecticut is also sluggish. Inventory levels are adequate in most areas, with a few contacts reporting isolated shortages. Prices are increasing at a rate of 3 percent, with individual appreciation rates ranging between 0 and 5 percent.

#### Nonbank Financial Services

Investment management firms report that both assets under management and net sales have increased since the beginning of 1996. Most respondents have increased employment in the last two months, particularly in retirement plan administration, computer systems, and operations; candidates are reportedly scarce in these segments of the job market.

#### The Outlook

The New England Economic Project (NEEP), a nonprofit forecasting group, released its semiannual regional forecast in May. NEEP projects 1.4 percent employment growth for New England in both 1996 and 1997, down from the 2.2 percent pace in 1995. Business and other non-health services are projected to show the fastest expansions in employment. The number of jobs in manufacturing and finance-insurance-real estate is expected to decline slightly in 1996, followed by a small increase in 1997.

## SECOND DISTRICT--NEW YORK

Second District economic conditions have shown some signs of improvement in recent weeks. Retail sales strengthened in May and were generally above plan, though they retreated in early June. While there has been some softening in New York City's commercial real estate market, the District's housing market has improved. The District's manufacturing sector accelerated sharply in May, according to purchasing managers in the New York City and Buffalo areas. Tourism remains exceptionally strong. There are some signs of price firming in a number of different sectors. Finally, banks report declining delinquency rates and steady growth in loan demand in May.

**Consumer Spending**

Retail sales in the district strengthened in May and were generally ahead of plan for the month, though business slowed noticeably in early June. There continued to be wide variation among the retailers surveyed in May, with same-store sales gains ranging from less than 1 percent to more than 10 percent, versus a year earlier. In general, upscale product lines continue to sell better than lower-end merchandise. Much of May's pickup was in seasonal merchandise (air conditioners, fans, swimwear, etc.) and was attributed to warm weather following an unusually cool April. It is unclear how much of the early-June slowdown was weather related.

A few retailers reported that inventories were a bit lean at the end of May, but with the early-June sales slump, inventories are generally back on or close to target. Virtually all retail contacts report that they are making fewer and smaller mark-downs on merchandise than last year, which has translated into a modest rise in effective selling prices. With little or no change in merchandise costs, this has boosted profit margins somewhat.

**Construction & Real Estate**

Commercial real estate markets in the New York metro area weakened slightly in May. After holding steady in April, office vacancy rates edged up in May, due to a drop in leasing activity and to new space coming on the market. Midtown Manhattan's vacancy rate rose from 14.2 percent to 14.8 percent (a 2-year high) at the end of May, while downtown's climbed from 24.6 percent to 24.9 percent.

The District's residential real estate markets have improved, on balance, though new construction activity remains at a low level. Realtors in New York state report that sales of existing homes picked up substantially in April, following a sluggish first quarter, while selling prices rose modestly. Permits to build new homes, particularly multi-family structures, are up sharply from a year ago—albeit from a very low base. Housing demand continues to be stronger downstate than upstate. Manhattan's residential rental market is particularly tight: vacancy rates are exceptionally low and rents on unregulated apartments have reportedly increased by more than 10 percent over the past year.

Realtors in northern New Jersey report that the market for existing homes is improving slowly but steadily, with both unit sales and average prices increasing at a 3-5% rate. However, homebuilders in northern New Jersey report that market conditions were weak in April and May—"in the pits", as described by one contact. With inventories of unsold homes at a relatively high 13 months worth of sales in May, builders have stopped virtually all speculative building. At the lower end of the market, which includes mostly existing homes, traffic and sales have been fairly good. In contrast, most newly built homes are higher priced and are moving very slowly. Concern over job security is viewed as the overriding constraint on demand for higher-priced homes.

### **Manufacturing**

Regional surveys of purchasing managers indicate a strong acceleration in manufacturing activity in May. Purchasing managers in Buffalo report that production activity, new orders, and employment all accelerated sharply in May, while commodity price pressures increased. Similarly, purchasers in metropolitan New York report a sharp improvement in manufacturing-sector conditions. The composite diffusion index signaled the strongest pace of growth in more than a year and a half, although there was only a modest increase in price pressures. (A separate diffusion index covering purchasing managers in New York City's non-manufacturing sectors signals continued moderate growth).

### **Other Business Activity**

The district's labor market was stable in April. New York state's unemployment rate edged

down from 6.5 percent to 6.4 percent, while New Jersey's edged up from 6.4 percent to 6.6 percent. Payroll employment growth slowed in April, following above-trend job creation in the first quarter. While part of this slowdown is due to an acceleration in job losses in manufacturing and government, much of it reflects a temporary statistical quirk: the survey week coincided with schools' spring break.

Tourism continues to boom, with hotel occupancy rates in New York City holding at 16-year highs through April, and average daily room rates posting double-digit gains over the past year. Two major transportation infrastructure projects were recently completed in northern New Jersey: a monorail system connecting Newark airport's three terminals, and a new rail link that facilitates the commute to midtown Manhattan.

### **Financial Developments**

Loan demand continued to increase, according to a survey of senior loan officers at small and medium sized banks in the District. Demand for commercial and industrial, as well as nonresidential mortgage loans, accelerated slightly in May, with demand higher at nearly 30 percent of the banks and steady at approximately 60 percent. However, demand for consumer loans grew at a slower pace than in April. Refinancing activity for all types of loans continued to dwindle, declining at approximately 40 percent of the banks and holding steady at close to 55 percent.

Loan delinquencies decreased across all segments in May. Just 8 percent of the banks reported rising delinquency rates, down from 19 percent in April. At nearly all of the banks surveyed, loan officers report that credit standards have not changed and that they are at least as willing to lend as they were two months ago. Average loan rates are higher or stable at almost all of the respondent banks. The spread between the average lending rates and deposit rates widened at close to 30 percent of the banks and held steady at 35 percent.

## THIRD DISTRICT - PHILADELPHIA

Economic activity in the Third District was increasing moderately in late May and early June, according to reports from various industry sectors. Manufacturers were continuing to see some gains in new orders and shipments. Retailers indicated that sales had picked up seasonally and were running a bit above the year-ago pace. Auto and light truck sales remained healthy, according to dealers, but sales of heavy-duty trucks have been slow. Bankers generally described lending as just steady overall. Residential realtors and home builders have seen increased sales in recent weeks. Commercial real estate markets were improving also, according to property managers. They reported a slight decline in office vacancy rates and some firming of rental rates since the beginning of the year, and they said that demand for warehouse space remained strong.

MANUFACTURING

Reports from Third District manufacturers in early June suggested that industrial activity was moving up modestly. Just over one-half of the firms contacted said their business was steady while one-third noted improvement. Gains were fairly widespread among the major manufacturing sectors in the region although lumber producers were seeing declining orders and instrument makers' shipments were falling. Overall, however, both new orders and shipments were moving up for area manufacturers. Area firms were also increasing employment, but gains appeared to be slight. On balance, manufacturers were trimming inventories, but there were few reports that stock levels were inordinately high; some firms in the paper and apparel industries noted higher than desired inventories.



Most area manufacturing firms reported that the prices they were paying for inputs and the prices they were charging for their products had been steady. Firms purchasing agricultural commodities continued to note that they were facing higher costs for raw materials, but most have not passed on these higher costs in the prices of their own products.

### RETAIL

Third District retailers said that above-normal temperatures in early May prompted sales of seasonal merchandise, such as air conditioners and summer apparel, but cooler weather in late May limited the gains. Nonetheless, in general, merchants contacted in early June said they were posting year-over-year dollar increases of a few percent. Most also said they were limiting promotional efforts and keeping inventories under control.

Auto dealers said sales of cars and light trucks have been good in recent weeks, in part because of the availability of manufacturers' rebates and price reductions to clear out end-of-model-year vehicles. Dealers continued to indicate that sales of used autos have been strong. A less positive trend characterizes the market for heavy-duty trucks, where sales have been flat.

### FINANCE

Third District bankers generally described loan demand as steady in early June. Demand for business credit has not been strong, and nonbank lenders have been competing for loans to middle market and small business firms. Bankers contacted for this report also said their consumer loan volumes have been essentially flat, partly because of slower growth in demand and partly because they were implementing somewhat stricter credit standards, especially for credit cards. Overall, Third District banks reported they were not adding to real estate loan volumes; however, there were reports that insurance companies have stepped up real estate

lending in the region recently.

#### REAL ESTATE AND CONSTRUCTION

Commercial real estate agents generally reported some improvement in conditions in major office markets of the Third District. According to commercial property companies that have conducted recent surveys, vacancy rates have edged down since the beginning of the year in the Philadelphia central business district to around 15 percent, and in most suburban areas in Pennsylvania to a range of 10 to 14 percent. The vacancy rate for office buildings in southern New Jersey has been flat at around 21 percent. Effective rents have been firming, according to commercial realtors, and there were fewer large blocks of space available. Realtors said this could prompt some build-to-suit or speculative office construction.

Demand for industrial space, especially warehouses, has remained strong in the region, according to realtors. Although the vacancy rate for industrial space has shown little change since the beginning of the year, commercial real estate agents said many currently unoccupied buildings are obsolete and were not attracting occupants. Instead, companies requiring space were contracting for new buildings, and there was some speculative construction as well.

Residential real estate sales have picked up in the region this spring, and housing construction has increased. Realtors said demand for new homes was relatively stronger than demand for existing homes and this was limiting price appreciation for existing homes that were being sold. Builders and realtors reported that purchases by first-time home buyers were underpinning sales of townhouses and homes at the lower end of the price range. Realtors said recent increases in mortgage rates did not appear to have had a significant effect on prospective home buyers' willingness to buy.

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### FOURTH DISTRICT - CLEVELAND

#### *General Business Conditions*

District business conditions remain firm and are generally expanding at a moderate or better pace. Although employment growth has been lackluster over the past few months, many regions report jobless rates well below the national average. In a few areas, such as central Ohio and northern Kentucky, unemployment stands at less than 4 percent. Although firms are having difficulty finding and retaining qualified workers in a variety of industries, occupations, and regions, only scattered reports of significant wage acceleration have been noted.

#### *Manufacturing*

Manufacturing activity continues to move ahead, although at a slightly uneven pace by industry. New orders growth, which had been quite strong in March and April, appears to have waned a bit recently. New export orders have been reasonably robust, however, and steel producers are noting reduced competition from imports. Orders strength is also reported in areas related to passenger cars and building and construction materials. Two notably weak areas in the industrial orders data are heavy trucks and industrial hydraulics.

Production continues to rise at a moderate pace. However, as has been the case over much of the past few years, higher output levels appear to be supported by increased hours and productivity gains, rather than by a significant growth in payrolls. Capital-goods

## IV-2

production continues to lead the industrial growth categories, although stronger production levels are reported in most industries.

Increased cost pressures are centered in petroleum-based products, including diesel fuel and a variety of plastics. Downward price movements are reported in paper products.

### *Consumers*

May was a relatively good month for District retailers. Sales of men's and women's sportswear were especially strong. However, wet weather may have been a negative factor for sales of home improvement and lawn and garden items, which were heavily promoted. Retail inventories continue to dwindle, and most are reported at or very near their desired levels. The labor market for skilled retail workers is characterized as tight.

Auto sales were fairly strong across the District in May, and most dealers reported improved sales over the previous few months. Warmer temperatures and the continuation of factory incentives are generally credited for the enhanced performance. Several sources indicated that replenished inventories were also a contributing factor. Dealers currently report that inventories are at or just slightly above desired levels, although some of the most popular models are still in short supply.

### *Agriculture*

Heavy rains and cool weather delayed the start of the District's planting season. Virtually all Fourth District acreage is currently underplanted, although conditions improve as you move south into Kentucky. Wet weather also has exacerbated plant

### IV-3

disease, reduced suitable grazing acreage, and slowed the harvest of feed crops, including alfalfa. Timely breaks in the weather have allowed significant progress in planting during the past few weeks, however, easing what was a critical situation for many crops, particularly corn.

With high grain prices and low stocks, some farmers are having difficulty delivering on “hedge-to-arrive” contracts with grain elevators. This, in turn, has created problems for some grain elevators that have sold futures in commodity markets, and a portion of these are reported to be seeking additional credit to meet margin calls. In Ohio, only a few such cases are considered to be serious.

#### *Banking and Credit*

Loan demands appear to have firmed somewhat in the past month, particularly in the consumer sector, where borrowing activity is generally described as strong. Lending patterns are quite mixed by institution, however. Credit extensions are reportedly up in both the automobile and credit card categories. Commercial credit growth is said to have slowed since the last District report, though, and a few large institutions have noted a substantial drop-off in commercial credit extensions over the past several weeks.

Competition for borrowers remains fierce, and credit quality is an ongoing issue at many institutions. Still, judged against historical patterns, loan delinquencies and charge-offs are low.

**FIFTH DISTRICT-RICHMOND**

**Overview:** Economic activity grew moderately in the Fifth District in May, with some firms straining capacity, but others experiencing weaker demand. Retail activity picked up while service-sector activity was mixed. Manufacturing activity continued to grow moderately overall, and some manufacturers indicated that capacity constraints limited further growth. Tourism grew at a faster pace and real estate activity strengthened. Mortgage loan demand weakened, but consumer loan demand strengthened. Markets for inputs, especially labor, tightened. Scattered price pressures were reported; expectations of future price increases were more widespread in manufacturing, but less apparent in the service sector. In agriculture, crop conditions improved.

**Retail Trade:** Retailers surveyed reported faster growth in retail sales, employment, average wages, big-ticket sales, and shopper traffic. Respondents also reported an increase in inventory growth. Retail prices rose more slowly in May and retailers expected their prices to rise more slowly during the next six months than they had in April. They anticipated a decrease in demand for their products over the next six months.

**Service Production:** Service producers surveyed by mail reported mixed activity in May. Revenues declined slightly and employment growth increased in May from April. Average wages increased faster in May. Service producers said prices rose more quickly in May than they had in April. Respondents expected demand for their product to soften over the next six months, and believed that their prices would rise more slowly.

**Manufacturing:** Manufacturing activity continued to expand at a moderate pace in May, and tight inputs markets constrained some firms. Except in Virginia, respondents to a mail survey reported faster growth in shipments. Virginia manufacturers said their production was hampered by a scarcity of skilled labor. A boat manufacturer and a textile producer also indicated that tight labor markets limited their production. Durable-goods producers were upbeat, reporting that new orders had strengthened in May. Several suppliers of industrial machinery and equipment reported that their lead time lengthened recently because demand strengthened and one said delays in receiving inputs reduced output at his firm. Manufacturers indicated that finished goods prices increased and raw materials

prices decreased in May from April. Respondents' six-month outlook was for higher finished goods and raw material prices.

**Tourism:** Tourist activity continued to pick up in May, despite a rainy Memorial Day weekend that dampened beach activity in some areas. Baltimore contacts attributed increased tourism to the Orioles' baseball team while respondents from mountain resorts cited vacation packages that emphasized golf and skeet shooting. Contacts reported that summer bookings looked good. However, one respondent from a popular North Carolina coastal area said tourist activity there was the slowest it has been in the last 10 years. Contacts expected summer rates to increase by 3.8 percent to 6.5 percent after adjusting for inflation.

**Port Activity:** Activity at District ports changed little in April from March and from a year ago. Port representatives continued to expect exports and imports to increase during the next six months, with exports expected to rise faster than imports. Several port contacts said that an increasing number of ship lines were entering into vessel sharing agreements, an arrangement that the contacts believed would lead to more ships calling at their ports during the next six months.

**Temporary Employment:** The demand for temporary workers increased in May. Demand was especially strong for light-industrial laborers and customer-service representatives. Several temporary agencies reported that their clients increasingly opted to use "contingent" workers rather than hire permanent employees. However, a North Carolina contact indicated that less employee turnover at firms in his area had reduced the demand for temporary workers. Temporary workers' wages changed little in May, although slight increases were reported in a few localities with low unemployment and for computer-skilled workers. Contacts generally expected stable wages during the next six months.

**Finance:** District contacts indicated that overall lending activity changed little in May. District mortgage loan companies said that demand weakened noticeably; one Virginia contact described demand as "crummy." Mortgage lenders reported particular weakness in refinancing activity and two contacts indicated that refinancings occurred only in cases of extreme financial necessity. Consumer lending strengthened during May but some respondents expected activity to moderate in coming weeks. Descriptions of commercial

lending ranged from very weak to very strong. Several contacts indicated business loans were mainly being used to finance activities other than fixed capital investment. District banks generally reported that they were "cautiously optimistic" about future loan demand.

**Residential Real Estate:** Residential real estate sales rose in May, but builders in some areas reported stagnant growth. Realtors reported increases in sales and customer traffic; some contacts describing the market as "terrific" and "outstanding." However, homebuilders indicated that customer interest in new homes declined; one builder reported that the weak market had forced her company out of business. Wages and materials prices increased. Several contacts said that higher petroleum prices had increased the cost of transported materials, such as lumber and concrete.

**Commercial Real Estate:** A telephone survey of commercial real estate brokers suggested that commercial real estate activity picked up in May and early June. Leasing activity remained brisk and, except in the District of Columbia, vacancy rates fell. Commercial rents increased, continuing a trend which began last November. The availability of prime office space continued to tighten, and nearly half the respondents reported shortages, particularly for large blocks of space. Contacts continued to report an increase in new construction, and one District of Columbia contact reported the construction of a new speculative office building there, an anomaly in recent years.

**State Revenues:** State tax collections were flat in the Carolinas but were higher in the other District states. Contacts across the District reported that strong 1995 capital gains led to higher May estimated tax payments. North Carolina and Virginia contacts said corporate tax collections were down significantly because of lower profits. Retail sales collections were higher in the District of Columbia, Maryland and South Carolina and real estate recordation receipts rose in Maryland, North Carolina, and West Virginia.

**Agriculture:** On balance, agricultural conditions improved in May and early June according to District analysts. Spring planting was almost complete. Recent rains brought relief to crops in dry areas of South Carolina, but led to flooding in some areas of West Virginia. Cooler temperatures caused some scattered freeze damage to the already-poor fruit crop. Despite these episodes, the weather was generally favorable for crops, and most were in good condition.



## SIXTH DISTRICT - ATLANTA

**Overview:** Reports from contacts in the District suggest that the Southeast economy continued to grow at a moderate pace during May. Retail sales largely met retailers expectations, with real sales apparently exceeding year-ago levels. Overall, manufacturing performance was mixed in May, although the outlook among manufacturers improved. Tourism and business travel continue to grow vigorously throughout the District, and this summer is expected to be especially strong. District Realtors report single-family home sales beat year-ago levels in May, while reports on home building compared to a year ago were mixed. Commercial and multifamily construction continued to increase. Bankers characterized overall loan demand as flat to slightly up. Wage pressures were reported in several parts of the region, especially for entry-level, low skill jobs. Some industries report higher materials and product prices.

**Consumer Spending:** According to District retailers, real sales increased modestly as same-store sales during May met or, more generally, exceeded, year-ago levels, even with the entry of many new competitors. Sales largely met expectations for the month. Inventories are said to be on target throughout most of the District. Apparel and cosmetic products were strong sellers across the District, while previously strong home-related product sales were mixed. Looking forward to summer, most managers anticipate sales will grow modestly in real terms over last year's levels.

**Manufacturing:** Manufacturers in the Southeast report mixed activity in May following an uptick the previous month. Plant production and the volume of new orders was said to have generally weakened, while materials inventories increased moderately. An increasing number of contacts noted declining employment rolls recently, although most continue to report steady payrolls. Looking ahead, however, reports indicated new orders for export mostly picked up modestly, and the outlook for production, orders, and capital expenditures, reportedly improved.

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Auto component suppliers in the region reported a shrinking factory workweek and slowing production because of mixed auto production schedules. Some producers of heavy duty trucks are trimming factory payrolls. Apparel producers continue to report intense competition from both here and abroad, resulting in further layoffs and excessive inventory accumulations. Industrial machine and electrical equipment producers say that markets are weakening following a period of strong growth. More positively, production, orders, and exports are improving for some pulp producers. Building product fabricators and manufacturers of household appliances report that employment is growing, and some plants are running at capacity because of strong markets. Steel mini-mills continue to expand in the region because of increased product demand and capacity constraints. And, a medical equipment manufacturer reports that order backlogs are growing.

**Tourism and Business Travel:** The tourism and convention sectors continue to boost the region's economy; industry contacts expect an especially strong summer. In central Florida, hotels are experiencing high occupancy rates, and theme parks are posting strong gains in attendance over last year. South Florida tourism officials note a healthy second quarter with modest growth from European and South American markets. Summer advance bookings at south Florida destination resorts are ahead of last year. Gambling revenues in Mississippi continue to grow, rising over 10 percent from a year ago for the first four months of this year. The opening of a new mega-casino in the state, employing 3,600 workers by the end of June, is expected to further boost state revenues. Atlanta's Hartsfield International Airport continues to post double digit gains in passenger traffic compared to last year as the Olympic Games draw near.

**Construction:** Most real estate contacts reported that single-family home sales were ahead of year-ago levels in May, and existing homes were selling much better than new homes. Builders and Realtors reported that inventory levels are adequate except in Nashville, where inventories remain tight.

### VI-3

Most contacts reported that home prices are stable, however, several indicated that new home prices were on the rise because of increases in both labor and material prices. The sales outlook among District Realtors remained optimistic, while building contacts were more cautious in their outlook for the remainder of the year.

Contacts from across the District report that commercial and multifamily real estate markets continue to improve. Low vacancy rates and higher rents continue to propel new industrial and office development. While most commercial projects continue to be build-to-suit, several speculative developments are underway and more are anticipated this year.

**Financial:** Contacts in the banking industry described overall loan demand as flat to slightly up in May from April and this period last year. Consumer lending was reported as stronger than last month and steady to slightly stronger than last year. Some strengthening was noted in autos. Commercial lending was said to be constant over both periods. Mortgage lending was flat to slightly up in May over last month and a year ago, with interest rate differentials propelling a general migration from fixed to adjustable rate mortgages. Lenders expect their mortgage activity will fall off during the rest of the year.

**Wages and Prices:** Contacts again report instances of wage pressures in parts of the region. Some retailers and service sector employers note that the labor supply is tightening, especially for low skill, or entry-level type jobs. In Atlanta, intense demand during the Olympics is raising wages for entry-level and temporary workers this summer.

Contacts report that prices for raw materials and output have increased marginally recently. Material price increases were noted by producers of packaging, plastics, apparel, machinery, and steel. Prices received are increased for producers of pulp wood, plastics, and some metals, according to factory contacts. Further out, material and finished goods prices are generally expected by contacts in the manufacturing sector to escalate moderately.

**SEVENTH DISTRICT--CHICAGO**

**Summary.** The Seventh District economy expanded at a slightly higher rate in May and early June than earlier in the year, led by a moderately expanding manufacturing sector. Retail sales continued to improve through April and May, while inclement weather dampened the sale of seasonal items and delayed many housing and construction projects in the District. Manufacturing activity continued to post modest gains in May, led by increased orders and production. Banking activity remained strong in most categories, although margins continued to be squeezed by competition for loans. Labor markets remained tight, manufacturers were increasing their payrolls, and spot shortages of qualified workers persisted. Grain prices retreated from record levels, but District farmers remained well behind in their plantings.

**Retail sales.** Retail sales in the District continued to improve through April and May and were up slightly in year-over-year comparisons. Several large retailers reported that sales growth in the Midwest was slightly below their national average. Most retailers reported that sales could have been better, but inclement weather hampered the sale of seasonal goods. Most contacts reported that inventories were in line with target levels for the coming Father's Day and summer sales events. The retail environment continued to be very competitive and a survey of small retailers in Michigan suggested that sales gains resulted from increasing promotional efforts. Auto dealers and distributors in the District reported that sales were very strong in May. One dealer reported that showroom traffic was up, model availability was adequate, and expectations remained high. Analysts at a June auto conference in the District reported raising their sales forecasts for the second half of 1996, although sales are not expected to continue at the strong pace set in the first half.

**Housing/construction.** Housing and construction activity slowed moderately in May and early June, but District sources attribute the bulk of this slowdown to inclement weather. New home sales increased slightly in April, but a survey of homebuilders suggested that sales in the Midwest were off moderately in May. Conversations with builders across the District confirm a May downturn, but one builder stated that the downturn was "75% weather, 25% (the recent rise in mortgage) interest rates." Realtors also reported a weather-related slowdown in traffic through existing homes in May. However, most builders and realtors contacted believe that the market is still very strong. In addition, the national survey showed that Midwest builders were the most

optimistic for the coming six months, although the rise in mortgage interest rates had dampened their optimism slightly. Lumber and cement dealers in the District reported a slowdown in shipments in May, but also noted that shipments picked up in early June. These dealers believe that most construction has been delayed due to inclement weather--not canceled--and have raised their expectations for the third quarter.

**Manufacturing.** Overall manufacturing activity in the District increased modestly in May and early June, while scattered pockets of softness persisted from earlier in the year. Purchasing managers' surveys from around the District continued to indicate solid gains in new orders and production, although backlogs continued to contract. Inventories varied from reports of accumulations in Michigan, some of which were intended, to liquidations in Wisconsin. The surveys were mixed with regard to prices paid, with declines reported in Michigan and increases reported in Wisconsin (primarily for commodities such as copper, aluminum, and fuel). An appliance industry analyst reported record high appliance shipments to dealers in April and shipments continued to indicate strength through May. However, some unplanned inventory building was also occurring. Several steel producers reported that order books were full through the third quarter, although competition from new capacity coming on stream over the next several months was restraining price increases. A diversified producer of specialized machinery, including material handling equipment, noted that orders were up in May and were well up year-to-date. Analysts cited continued softness in the heavy construction and heavy-duty truck industries, but in both cases, orders through May were slightly better than the industry had expected earlier in the year.

**Banking.** Reports from District bankers continued to be upbeat, although competition was widely described as being intense. Most contacts reported that consumer lending activity continued to be strong, with one bank reporting some pickup in loans for the financing of new car leases. Although home refinancing activity virtually stopped in recent weeks, new originations remained fairly strong. One banker noted that loan demand for low-end housing was doing much better than for luxury homes. C&I lending continued at a high level in May, with some contacts reporting continued solid growth while others noted a decline from the peak levels reached in late 1995. While credit quality remained generally high and delinquencies remained low in recent weeks, one banker expressed concern over the increase in local bankruptcies, especially among older businesses

## VII-3

(including several retailers). Despite the high lending volume, bankers generally reported downward pressure on margins, with new banks moving into local markets and customers becoming more selective in their choice of banks.

**Labor markets.** Employment remained at record levels for the District through May and early June and spot labor shortages continued. A national survey of employers reported that Midwest employers continued to have the most optimistic hiring plans of any region heading into the third quarter, led by expected strength in the manufacturing and construction industries. Manufacturing employment rebounded in April after two months of slight decline, and purchasing managers' surveys from around the District suggested that moderate growth in manufacturing payrolls had continued through May. Construction employment increased seasonally despite adverse weather conditions across much of the District which hindered the progress of many projects. Several sources reported that shortages of qualified workers persisted in most major markets, but may be easing somewhat due to a summer influx of students into the temporary labor force. Increases in the starting wage of entry-level workers over the last year seem to have tapered off. However, several contacts reported that most employers were willing to pay slightly more to keep good employees. Temporary help agencies reported a shift from temporary to temp-to-permanent assignments, suggesting employer optimism about continued strength in the economy.

**Agriculture.** Cash and futures grain prices recently moved lower from record highs as export demand waned and favorable weather conditions improved prospects for the wheat harvest and allowed farmers to make progress in planting corn and soybeans. However, prices remained well above year-earlier levels. Despite recent progress, the pace of crop plantings continued to lag in District states. Corn planting in Indiana and Michigan was significantly delayed and progress in soybean planting was also running behind the normal pace in all District states. In contrast, corn planting in Iowa was nearing completion. Many planted cornfields were plagued by cool temperatures and excessive rainfall, leading to low surviving plant populations and forcing farmers to consider the added expense and uncertainty of replanting.

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### EIGHTH DISTRICT - ST. LOUIS

#### **Summary**

The pace of economic activity in the District continues to pick up from the more sluggish levels noted earlier in the year. District retailers and auto dealers report recent sales activity at or above last year's levels, and most contacts are optimistic about sales prospects over the summer. Contacts remain concerned about tight labor markets and the shortage of entry-level and certain skilled workers. Residential construction has expanded significantly in most parts of the District, while nonresidential construction has slowed somewhat in a few areas. Loans outstanding at large District banks have declined during the past two months. District crops are in mostly good condition, although spring planting in some areas remains well behind last year's pace.

#### **Consumer Spending**

Most retailers surveyed report that recent sales are at or above last year's levels. Almost half of the respondents indicate that sales exceeded expectations. Most also anticipate a modest or significant increase in this summer's sales over last year's, primarily because of expected increases in tourism. Some retailers in St. Louis, however, are less optimistic about summer sales because of the strike against McDonnell Douglas by about 6,700 union machinists. Although some retailers in Arkansas anticipate price increases this fall, most expect no price changes and have no plans to use heavy discounting to move merchandise.

Many District auto dealers report recent increases in sales levels; however, some Louisville dealers report a slight decline in April sales. Almost half of the surveyed dealers have been using rebates and other incentives more than usual, and some St. Louis and Memphis contacts credit these programs for their recent sales increases. Although a few contacts have noticed that consumers are

## VIII-2

purchasing used rather than new cars, other dealers report no significant substitution. Most surveyed dealers anticipate this year's sales to be the same or better than last year's.

### **Manufacturing and Other Business Activity**

Reports from District contacts continue to be generally upbeat. The general tone of comments is that while the economy continues to grow at a steady pace, there is a growing concern about labor shortages. One contact reports fast-food establishments offering starting wages well above the minimum wage and signing bonuses of up to \$250 to attract employees. The majority of contacts note that construction and other skilled trade workers are the most difficult to find. "Poaching"—one company luring workers away from another—has been used by numerous District firms, particularly retailers, contacts also report.

Many firms, especially in the southern parts of the District, report slight declines in last month's and year-to-date sales levels over the same period last year. A representative from a textile company, however, reports that sales are up strongly over last year and are expected to continue on this path. Many contacts report that their inventories are too high and plan to cut prices to reduce stocks. A National Federation of Independent Business (NFIB) survey of District firms in May, though, found that one-fifth of surveyed firms plan to increase their inventories during the next six months; about one-sixth plan to cut inventories. Many contacts also report that, in most cases, they still cannot pass along increased materials' prices to consumers because of competition. According to the NFIB survey, however, about one-fourth of the respondents have increased prices over the past three months, and about one-fifth plan to increase them in the next three months.

### **Real Estate and Construction**

The number of residential construction permits issued in April in most District metropolitan areas increased significantly. Eight of the District's 12 metro areas saw monthly permits increase by



### VIII-3

as much as 65 percent. Year-to-date permits are up in 10 District metro areas. Some areas, especially southern Illinois and Arkansas, are experiencing a shortage of mid-priced homes (\$100,000 to \$150,000). Nonresidential construction seems to have slowed in a few areas, particularly western Tennessee and Arkansas.

#### **Banking and Finance**

Total loans outstanding at 11 large District banks declined 2.9 percent from early April through late May after rising 3.6 percent from early February through late March. Real estate loans, which comprise about two-fifths of the banks' loans, experienced the sharpest decline; they fell 4.6 percent in April and May after rising 6.2 percent in February and March. Business and consumer loans dropped 2.1 percent and 1 percent, respectively, after increases of 0.9 percent and 3.4 percent, respectively.

#### **Agriculture and Natural Resources**

Crops are generally in good condition, except in extreme northern portions of the District, which have seen an unusually cold, wet spring. Increased input prices are the rule rather than the exception this year. Besides the uptick in energy prices, fertilizer prices are holding firm at last year's high levels. Some livestock and catfish producers note that increased grain prices are having an adverse effect on their access to credit because of an expected decline in profits. Land prices are reportedly rising in parts of Arkansas and western Tennessee. Southern pine lumber mills report that timber prices have fallen recently because of an excess inventory of saw logs. Activity at lumber mills is reportedly running below last year's pace.

**NINTH DISTRICT--MINNEAPOLIS**

Economic growth in the Ninth District continues to quicken in late spring. Construction is strong in virtually all parts of the district. Natural resource industries, except for paper, are robust. Vehicle sales reportedly have improved from earlier in the year and general merchandise retailers report satisfactory business. Agricultural producers are generally optimistic in spite of late planting caused by adverse weather. Similarly, tourism got off to a late start due to cold, wet weather, but business owners and state tourism officials anticipate a good season. Manufacturing continues mixed, but on balance shows some invigoration. Except for products derived from grains or petroleum, there are few reports of price increases. Difficulty in securing needed workers is the most common complaint voiced in regard to labor markets.

Construction and real estate

“Home buyers find a lot to look at, housing prices up over 95’s market” is a Sioux Falls, S.D., newspaper’s characterization of residential real estate that could apply equally well to most other urban areas of the district. Construction is up from year-earlier levels and sales of new and existing homes are brisk in most areas. New permit applications in Sioux Falls for the four months through April were up some 75 percent from the same months in 1995. For the Minneapolis-St. Paul metro area the increase was 25 percent in the same period. Sales of new and existing housing are also lively in western Montana, especially Missoula. A report from Bismarck, N. D., describes “commercial construction at a blistering pace.” Contracts for large projects continue to run slightly ahead of 1995 levels.

Natural resource industries

“More taconite, more jobs,” was the headline of an article describing one firm’s plans to reopen a processing plant at a Minnesota iron mine. Idled in 1980, the plant would add about 100 jobs and 1.3 million tons of annual output. “All seven Iron Range taconite plants are turning out pellets at near record levels,” the article continues. In a similar vein, oil and gas drilling in North Dakota and Montana continues well above 1995 levels.

In forest product industries, lumber mills and oriented-strand board plants are busy, but paper production continues down from a year ago and well below capacity.

### Agriculture

“The outlook is good if the crop materializes,” reports one North Dakota banker responding to the Minneapolis Fed quarterly survey of agricultural credit conditions. That view is shared in all states of the district. Planting lagged two to four weeks behind long-term averages, but moisture conditions are generally favorable except in eastern North Dakota where many areas are too wet. While most crops were planted in time to allow maturation before fall frosts, some potential yield has been lost and weather conditions will need to be ideal for the crop to be much above average.

Hog prices are higher than anticipated, shielding producers somewhat from the effects of sharply higher feed costs. Conditions for beef producers remain grim, and bankers report that they expect the number of ranch liquidations to rise perceptibly this year.

Interest rates on farm loans rose slightly in the second quarter, and bankers’ expectations of loan repayment, farm income and capital spending continue to improve in most areas except where cattle ranching predominates.

### Manufacturing

“Business is quite good, especially on exports,” says a purchasing manager at a large Minneapolis food processor. “I’d say things are a little slow,” reports the CEO of one N. D., manufacturing firm, “but we expect it to pick up pretty soon.” Such comments illustrate the mixed conditions faced by Ninth District manufacturers. None report delays in receiving raw materials or any other evidence of rapid growth in their sector. Inventories are generally reported as normal. Reports for publicly traded manufacturers generally show good sales and earnings growth over year-earlier levels, particularly for food processors and farm and construction machinery manufacturers. On balance, indications of growth appear to predominate, and those firms reporting slow sales now expect some improvement in the next few months.

### Consumer spending

“First quarter retail sales tax is coming in a bit above projections and about 4 percent above last year,” reports a North Dakota state tax official. That seems typical of retail sales in many areas, not booming but up from a year ago and strengthening. Mall managers and regional retailers report good business, though few use superlatives in their descriptions. Auto sales are reportedly “stable” in Montana, “pretty good” in Minnesota, and “still good” in South Dakota. New vehicle registrations in these states are slightly ahead of 1995 levels for the year to date, with most of the improvement in April and May.

### Tourism

“Tourist season off to damp start,” headlined a description of slow business for South Dakota tourism firms as snow fell at Mt. Rushmore on the Memorial Day weekend. But in spite of a slow start, some are optimistic. “We’re looking for our best year ever, our reservations are up about 20 percent above last year,” said one park manager. The situation seems very similar in the rest of district states, a late start due to cold, wet weather, but optimism about the coming season.

### Employment, wages and prices

“Perhaps we should call them ‘discouraged employers,’” said a Minnesota state official describing the growing phenomenon of firms that want to hire additional skilled workers, but stop advertising because no candidates are forthcoming. Printers and computer-aided design and manufacturing technicians were cited as in especially short supply. One Minnesota firm offered a drawing for a free Las Vegas vacation to employees who brought in a new hire. A Minnesota economic development official said that labor availability has displaced incentives, taxes and other business climate issues as the primary concern of firms seeking to establish plants. This parallels the dilemma that eastern South Dakota has faced for some time; it is difficult to attract new industry when labor seems short.

“We have the person who posts price changes doing filing,” says a Minnesota plumbing supply wholesaler who describes a few increases in copper and polyvinyl chloride pipe as offset by declines in prices of furnaces and other manufactured items. While fuel prices have received much attention, the average pump price for gasoline in the Minneapolis-St. Paul area at the end of May was only 6 percent above year-earlier levels. Grain prices remain at historic levels in nominal terms, and flour price increases now roughly parallel those of wheat after lagging somewhat earlier in the year. But there is little evidence of price pressure at the supermarket. Beef is frequently on sale and aggressive promotions of breakfast cereals and some other processed foods have helped minimize food price increases.

## TENTH DISTRICT - KANSAS CITY

**Overview.** The district economy continued to grow at a moderate pace during the past month. Retail sales, manufacturing, and construction activity strengthened, while activity in the energy industry increased slightly. Farm income prospects remained weak, however, due to a poor wheat crop and low cattle prices. Labor markets remained tight for both entry-level and skilled workers, but wages generally held steady. Prices for some materials used in manufacturing and construction increased slightly, but retail prices held steady.

**Retail Sales.** Retailers report sales increased modestly during the past month and remained above last year's level. Sales of men's apparel were strong, although sales of home furnishings were weak. Retailers generally expect sales to strengthen during the next few months. While retailers indicate satisfaction with their current inventory levels, most plan to increase inventory purchases through the remainder of the year. Automobile dealers report sales increased modestly last month. The dealers expect further sales gains in the months ahead and note that demand for light trucks and sport utility vehicles exceeds the available supply.

**Manufacturing.** Manufacturers continued to operate at high rates of capacity use. None of the manufacturers, though, report production bottlenecks due to capacity constraints. Manufacturing materials were readily available, and lead times for obtaining materials were unchanged. Most manufacturers were satisfied with inventory levels, although a few were trimming inventories of finished goods. A late-April survey of district manufacturers indicated the pace of manufacturing activity had strengthened since earlier in the year, and manufacturers expected further gains in coming months.

**Housing.** Most builders report housing starts increased last month and remained above last year's level. Most of the gains were in single-family construction, with smaller gains in

multifamily units. Builders generally expect homebuilding activity to remain brisk during the summer months. Sales of new homes increased slightly last month and remained above last year's pace. Builders were satisfied with current inventories of unsold homes, which were at a normal level for the season. Prices of new homes last month held steady at a level somewhat higher than last year's. Construction materials are readily available, and builders expect little change in availability or delivery times in the next few months. Builders expect lumber prices to increase further, however, before leveling off later in the year. Mortgage lenders expect mortgage demand to remain strong throughout the summer.

**Banking.** Loans generally grew faster than deposits at respondent banks last month, slightly pushing up loan-deposit ratios. Most banks report gains in commercial and industrial loans, consumer loans, home mortgage loans, home equity loans, and commercial real estate loans. Residential construction loans held steady, and agricultural loans declined. Security investments were down slightly.

Most banks report a slight increase in total deposits, with gains in MMDAs, large CDs, and small time and savings deposits. Demand deposits, NOW accounts, and IRA and Keogh accounts held steady.

None of the respondent banks changed their prime rate last month, and none expect a change in the near future. Most banks also held their consumer lending rates steady and anticipate no changes in the near term. Lending standards were generally unchanged.

**Energy.** Activity in the district energy industry increased slightly in May, despite declining energy prices. Prices of crude oil and natural gas fell sharply in May but remained well above last year's level. The number of drilling rigs operating in the district at the end of the month increased slightly to a level about 9 percent above a year ago.

**Agriculture.** Recent wet weather has improved prospects for district crop production. The rains generally arrived too late to salvage the wheat crop in Kansas and Oklahoma, where farmers may harvest less than half a normal crop. But the rains will likely boost wheat yields in the northern half of the district. The additional soil moisture also improves prospects for milo and other crops some farmers will plant to replace failed wheat fields.

The district cattle industry remains trapped between low cattle prices and high feed costs. As a result, district feedlots have trimmed production schedules, and many are operating at less than full capacity. With demand for young feeder cattle down, district ranchers are reducing the size of breeding herds. Few ranchers are exiting the industry altogether, but many are trimming herds by aggressively culling lower quality cows.

High crop prices should offset crop losses for many district farmers and boost incomes for those who harvest normal or near normal crops. Nevertheless, with a poor wheat crop in prospect and losses accumulating in the cattle industry, agricultural bankers expect a sizable increase in the number of farm loans to be refinanced this fall. Overall, some erosion in equity is likely this year for many district farmers and ranchers, but strong balance sheets should enable most to survive the tough year.

**Wages and Prices.** Labor markets remain tight in much of the district, with employers reporting tight supplies of both entry-level and skilled labor. Some retailers report a shortage in both the quantity and the quality of available workers, but wages have continued to hold steady since a normal year-end increase. Manufacturers report rising prices for some materials, especially petrochemicals, and builders report rising lumber prices. Retail prices held steady last month but remained somewhat higher than last year's level. Most retailers expect prices to remain stable in the months ahead.

**ELEVENTH DISTRICT--DALLAS**

Eleventh District economic activity rose at a steady pace in late April and May, and contacts were optimistic about future business conditions. Orders for nearly all manufactured products increased. The most notable exception was orders for semiconductors which continued to plunge, driven by lower-than-expected computer sales. Construction activity remained strong, boosting demand for most construction-related products. The financial services industry held steady, and retail sales improved slightly. Energy activity strengthened despite lower oil prices than reported in the last survey. Drought continued to hamper the agricultural sector.

**Prices and Wages**

Respondents in several industries noted rising price pressures. Prices were up for paper, brick, steel, cement, lumber and some chemicals, and prices stabilized for corrugated box liner after falling in previous months. In contrast, prices for semiconductors continued to fall. Contacts in construction-related industries--notably steel, brick, cement and glass--expected further price increases later in the year due to strong demand and dwindling inventories. High demand was reportedly causing rents to rise for office and warehouse space. Livestock prices remained low, but food processors said high grain prices continue to boost costs. In the energy industry, oil prices fell to near \$20 per barrel after news of pending Iraqi sales of \$1 billion per quarter, however, gasoline and natural gas prices are expected to remain strong through the summer. Reports of wage pressures were minimal, except for a few respondents who were concerned about rising costs associated with a higher minimum wage.

**Manufacturing**

Manufacturing orders rose steadily over the past six weeks. The most notable exception was



semiconductor orders which continued to plunge. Contacts in the semiconductor industry said demand was down for all types of semiconductors, not just DRAMs as noted in previous reports, and inventories were rising. The weakness was attributed to slower-than-expected demand for computers and computer-related products. Contacts in the electronics industry were more pessimistic in their outlooks and did not expect orders to bottom out for another three to six months. On a more positive note, demand increased for most construction-related products. Respondents said an increase in brick orders had reduced inventories, and cement shortages were reportedly worsening due to a pickup in commercial and residential construction. Strong construction activity also boosted demand for glass, steel and other metal products, and inventories were on the small side. Contacts in the paper industry said demand for several products, including corrugated box liners and recycled paper, had bottomed out after falling for the past three months. Apparel manufacturers noted somewhat stronger demand due to an improving retail environment, and several had increased hiring recently. The Gulf Coast petrochemical market continued to improve, with good domestic demand, although profits have been pressured by higher costs of oil and natural gas feedstocks. Oil field machinery companies reported improving demand, driven by strong international and offshore drilling.

### **Retail and Auto Sales**

Retail sales improved in May, thanks in large part to an increase in demand for women's apparel. Sales of lawn and garden materials were also strong according to respondents. Most contacts reported no inventory problems, but some retailers were letting their inventories thin by not adjusting to the recent increase in demand. Sales along the Texas-Mexico border continued to improve slowly. Auto sales remained brisk in late April and May, and several contacts said inventories were dwindling.

### **Financial services**

Contacts in the financial services industry reported steady loan demand over the past six

weeks. The only exception was residential refinancings which continued to fall. Contacts said demand for consumer and commercial real estate loans remained at good levels. District lenders expect loan demand to remain steady over the next three to twelve months.

### **Construction and Real Estate**

Construction and real estate activity continued to rise, according to respondents.

Homebuilders reported strong demand for new homes despite higher mortgage rates, and sales of existing homes were also brisk. Although apartment leasing remained strong, new completions caused some developers to make concessions, such as a free month's rent, in order to attract tenants. While downtown areas still have excess office space, contacts said suburban markets are the tightest they have been in over a decade and rents are rising as a result.

### **Energy**

Despite slipping oil prices, energy industry activity improved over the past six weeks, according to contacts. Demand for oil services was driven by strong international, offshore and domestic drilling activity. Natural gas drilling in the Gulf of Mexico has virtually squeezed out oil drilling as producers seek to take advantage of expected high natural gas prices through the summer months. The global offshore market, including the Gulf of Mexico, is rig-constrained with significant investment necessary to bring more equipment on line.

### **Agriculture**

Drought continues to impede agricultural production. Contacts rated crop conditions as mostly good to fair, although Texas winter wheat producers expect to harvest 27 percent less than both the 1995 crop and 1994 crop. Range and pasture conditions were rated as fair to very poor across the state, and livestock operators continue to downsize their herds in response to weak prices and high feed costs.

TWELFTH DISTRICT -- SAN FRANCISCO

Summary

Reports from contacts in the Twelfth District indicated continued strong economic activity in recent months, with some hints of an acceleration in economic growth. Residential real estate sales volumes and construction generally moved higher, and moderate growth of consumer spending continued. District manufacturing activity picked up in recent months, particularly among suppliers of building-related products. Although businesses are increasingly optimistic about the outlook for regional and national economic growth, about one-third of respondents expect inflation to worsen over the next four quarters.

Business Sentiment

Businesses are increasingly optimistic about the outlook for national and regional economic growth, with about 90 percent of respondents now expecting national growth over the next four quarters to match or exceed its long-run average pace, up from a recent low of about 40 percent in February. More than half of business contacts expect no substantial change in national unemployment or inflation in the near term, but about 37 percent of respondents expect inflation to worsen over the next four quarters, up from 19 percent in February. Respondents'

expectations for regional economic growth are particularly optimistic, with about 70 percent predicting better growth in the region than in the U.S. as a whole.

#### Retail Trade and Services

Retail sales in most District states reportedly were strong and increasing in recent months. Many respondents from the fast-growing Intermountain states identified auto sales as a spending category with particularly large gains, but spending on nondurables, such as food and clothing, also was reported to be up noticeably in these states. Retail sales appear to be accelerating in Washington, after slowing around the turn of the year. Within California, retail spending reportedly has been particularly strong in the San Francisco Bay Area, and most respondents from Southern California noted a firming of consumer spending there. Throughout the District, retailers have experienced increased shipping costs from the spike in fuel costs, and most report the fast passthrough of such higher costs to retail prices.

Tourism activity reportedly is increasing in California, Utah, and some other District states. Hotel occupancy rates reportedly have been high in recent months, although some respondents did express concern that plans for long-distance driving vacations could be affected by the run-up in gasoline prices. Among other service-producing industries, computer-related business services activity reportedly is increasing

rapidly in Washington and Northern California, where demand for telecommunications services also remains strong. Long-distance trucking services remain in high demand throughout the District, despite the recent introduction of fuel surcharges by shipping companies.

### Manufacturing

District manufacturing activity picked up in recent months, particularly among suppliers of building-related products. Manufacturers of construction machinery reportedly benefited from increased sales, and orders for wood products such as lumber were solid. In the Pacific Northwest, manufacturers of specialty construction items were having trouble keeping up with the strong pace of orders, so delivery lags lengthened. Among other investment goods, order backlogs for machine tools were reported to be high; demand for computing equipment remained robust, but the pace of increase appeared to slow a bit. The inventory correction which has dampened production in industries such as steel, autos, and selected other consumer goods, was perceived to be near completion.

### Agriculture and Resource-Related Industries

District agricultural producers report mixed conditions. Western cattle ranchers lament a continued drop in cattle prices, as livestock producers still have not worked off excess inventory. In California, production of nuts, tree fruits and

grapes appears to be slightly down this season, although grape producers are benefiting from very high demand for wine grapes.

#### Real Estate and Construction

District real estate markets were relatively strong in recent months. Respondents noted increasing home sales volumes and prices, and residential building activity also increased. The growth of new residential construction was particularly strong in Oregon, Utah, and Idaho. Within California, real estate and residential construction activity continued to be mixed, with stronger conditions in the San Francisco Bay Area than in the Central Valley and Southern California.

#### Financial Institutions

District bank respondents generally report wide availability of credit, with high levels of bank liquidity, strong capital positions, and healthy earnings. Loan volumes were reported to be increasing at selected banks. Increased economic activity reportedly is fueling a strong loan market in the San Francisco Bay Area. However, some California banks are experiencing slower loan growth, with much of the weakness centered in consumer loans and first mortgages. In Washington, loan volumes are robust, particularly in the commercial and industrial lines. Some bank respondents reported difficulties hiring bank tellers at the prevailing wages, particularly in the tightest labor markets, such as Salt Lake City and Las Vegas.