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Summary of Commentary on _____

Current Economic Conditions

by Federal Reserve District

September 1997

SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICTS

SEPTEMBER 1997

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SUMMARY*

Economic activity expanded in July and August in all twelve Federal Reserve Districts. Although some districts note signs of slowing in selected sectors, about half the districts say their region's overall pace picked up in July and August while the others report continued moderate growth. Retail results range from "mixed" to growing at a "solid clip." Manufacturers report generally rising orders and revenues, with durables manufacturing especially strong. Residential and commercial real estate markets are mostly improving, although the level of new construction activity varies widely. While most energy suppliers are seeing improvements, other natural resource industries and agriculture show considerable variability as a result of weather and other factors.

Most regions are experiencing tight labor markets, recruiting difficulties, or growing labor shortages. Two-thirds of the districts, however, report that these supply-demand imbalances are not translating into generally higher wages, although wages may be rising faster in selected industries, occupations, firms, or localities. Several districts note that firms are using creative recruiting or compensation techniques to reduce the pressure on wages. With a few exceptions, prices for goods are said to be moving very little, if at all, at the manufacturing level for inputs or finished goods, and at the retail level.

CONSUMER SPENDING

Most districts report that retail sales are growing at a fairly moderate pace. Exceptions are the Minneapolis and San Francisco districts, which report very strong sales growth. Only the Richmond district says that sales growth has slowed, albeit from a brisk to a more moderate pace. Districts

*Prepared at the Federal Reserve Bank of Boston and based on information collected before September 8, 1997. This document summarizes comments received from businesses and other contacts outside the Federal Reserve and is not a commentary on the views of Federal Reserve officials.

reporting unanticipated increases in sales activity are Chicago and Dallas. In most districts, inventories are at desired levels. However, Chicago reports lower inventories due to a weather-related increase in sales, while Richmond reports inventory accumulation as a result of moderating sales growth.

Sales of apparel, other back-to-school items, and tourism are said to be very strong in most districts. In addition, the St. Louis and San Francisco districts say that sportswear and sporting goods sales are strong, while Boston, New York, and Cleveland cite strength in home furnishing sales. Sales of appliances and other consumer durables are mixed, with almost half the districts (Boston, Richmond, St. Louis, Minneapolis, and San Francisco) reporting weak sales results, but New York and Cleveland experiencing strong sales. Although San Francisco reports generally solid retail sales growth in the district, softness is noted in Utah's retail and tourism businesses.

All districts report tight labor markets and difficulty attracting and keeping retail employees. Nonetheless, most districts say that wages are either holding steady or rising only moderately. Only the Richmond district notes sharp wage increases in the retail sector. There is little evidence of price pressures at the retail level; in most districts, both consumer and vendor prices are stable. Only Dallas and New York say that consumer prices are rising, albeit slowly.

MANUFACTURING

Manufacturing activity is reported to be at a high level and rising moderately throughout much of the nation. Richmond, Chicago, Minneapolis, and Dallas note that business was accelerating or exceeding expectations. The most restrained commentary comes from Cleveland, where production has moderated but conditions remain "good or better," and Atlanta, which indicates only "slight" improvements in manufacturing activity. Most other districts cite steady growth in shipments or orders.

Durables manufacturers appear to be doing particularly well; districts typically cite strong or accelerating demand for computers and other business equipment, metals, machine tools, aircraft, and heavy equipment. Steel mills, in particular, are said to be struggling to build inventories to meet strong demand from such sectors as construction, oil and gas, and machinery. According to Chicago, light

vehicle production will be higher this quarter than last (in part to rebuild stocks depleted during labor stoppages) and order backlogs are increasing for heavy trucks. Several districts indicate growing sales of furniture and lumber, although San Francisco notes that declining foreign demand and rising imports had a depressing effect on sales and prices of wood and lumber products in that district.

Nondurables manufacturing results are mixed. Oil refineries were operating at record high levels of capacity utilization this summer, according to Dallas. However, Atlanta and St. Louis note layoffs in the apparel industry, and Minneapolis and Dallas mention sluggish conditions in food processing

Several districts report that the United Parcel Service strike created temporary disruptions, and rail shipments have been a problem in the Dallas district. Otherwise, there are no indications of unusual delivery lags.

In general, materials cost pressures are described as modest, although several districts indicate that manufacturers are paying higher prices for metals and packaging. Output prices largely remain in check, with Chicago and San Francisco noting a heightening of competitive pressures as a result of the appreciation in the value of the dollar

Reports of tight labor markets are widespread, but manufacturers appear to be facing only selective hiring bottlenecks or pay pressures. Boston, Atlanta, Minneapolis, Kansas City, and San Francisco report stiff competition or accelerating compensation for workers in technical and other specialized occupations. Kansas City manufacturers were also experiencing difficulties hiring production workers. Only Richmond indicates generalized wage acceleration and hiring concerns among manufacturers, while Cleveland exemplifies the other extreme, citing "no significant labor shortages or wage increases."

REAL ESTATE AND CONSTRUCTION

Most districts report moderate activity in residential real estate markets. A modest increase in sales of existing homes is cited by Boston, New York (upstate only), Richmond, Chicago, Dallas, and

San Francisco (in southern California, Oregon, and Washington). However, Boston reports a decline in condominium sales, Chicago a drop in new home sales, and San Francisco a decline in the volume of sales in Utah. Philadelphia, Atlanta, and Kansas City indicate no notable changes in sales. Home prices remained relatively steady everywhere except for the Twelfth District, where large price increases are noted in California, Washington, and Alaska. Excess inventory of existing homes is reported by Philadelphia, Atlanta, and St. Louis.

Commercial real estate markets have been strong in most districts that reported on this activity. Vacancy rates declined in New York, Philadelphia, Atlanta, Dallas, and San Francisco, with particularly strong office markets. Despite the declines in vacancy rates, almost no districts note rising rents. Philadelphia reports a slight increase in rental rates but indicates that new construction could cause them to decrease. Rising commercial construction is reported by Philadelphia, Richmond, Atlanta, Minneapolis, and Dallas.

BANKING AND FINANCE

Overall lending activity rose in most districts, with slow growth in Richmond and Philadelphia and moderate gains in New York, Dallas, and San Francisco. Among loan types, consumer lending softened in several districts. Commercial loans and home mortgages account for most of the overall increase, although in Atlanta, Cleveland, and Philadelphia commercial lending continued flat or fell slightly.

Delinquency rates for both commercial and consumer loans continued stable to improved across the country. Several districts report improved asset quality and some tightening in credit standards, although New York and Chicago note some apparent easing of standards for consumer credit and commercial mortgages, respectively.

A number of districts mention continued strong competition among banks and other institutions, especially for commercial and industrial loans. Philadelphia bankers note ongoing competition from commercial finance and specialized small business lenders, while Dallas says that

stiff competition is exerting pressure on loan rates. San Francisco and Kansas City report a drop in bank deposits, citing strength in equity markets.

NONFINANCIAL SERVICES

Temporary employment firms and other service providers continue to expand in all districts, with the exception of Richmond, where service-sector revenue growth eased slightly. Those districts contacting temporary employment or staffing agencies indicate that labor markets tightened further. Many districts report strong competition for highly skilled workers, especially those in computer-related fields. Temporary employment agencies in the Cleveland district describe high demand for clerical and light industrial laborers, and some San Francisco services respondents note a tightening market for entry-level workers. Boston, Cleveland, Dallas, and Richmond report wage increases in the service sector as demand continues to outpace supply.

AGRICULTURE AND NATURAL RESOURCES

Although recent rains have improved crop conditions in some areas, hot dry weather earlier in the year reportedly reduced the corn, soybean, hay, and fruit crops in parts of the Cleveland, Richmond, St. Louis, and Chicago districts. However, in Minneapolis, Kansas City, and Dallas, where yields have been relatively good, producers are benefiting from favorable corn and soybean prices. Prospects for the cotton crop have improved in St. Louis and are good in Dallas, while the winter wheat harvest is likely to exceed 1996 levels in Cleveland but to be no more than average in Minneapolis. Richmond, Minneapolis, Kansas City, Dallas, and San Francisco all report strong demand and favorable price conditions for poultry and livestock products. Benefiting from good pasture and good prices, Minneapolis and Kansas City ranchers are reportedly building breeding herds or holding calves until the spring of 1998. Contacts also note growing exports of pork and of beef to Mexico and Southeast Asia.

Reports on the oil sector indicate that continued strong demand for energy products has led to price increases, good profits, and a resurgence in oil and gas exploration activities. In the Minneapolis, Kansas City, and Dallas districts, rig counts are at their highest levels in years. While prices remain

below their late 1996 levels, supplies are currently tight; however, seasonal declines in gasoline prices are expected soon, and mild weather damped down energy prices in the San Francisco district.

Contacts in Atlanta note that the resurgence of the energy sector along the Gulf Coast has produced strong demand for geoscientists and petroleum engineers, while some Dallas contacts believe that a shortage of experienced crews may limit future drilling activity.

FIRST DISTRICT - BOSTON

The First District economy continues to expand steadily. Sales are rising at most retail, manufacturing, and temporary employment firms contacted. Meanwhile, investment management firms continue to see increases in assets under management, and residential real estate markets are doing well. Manufacturers and retailers say wages are rising 3 to 5 percent and prices are generally level.

Retail

Most retail contacts report that sales have been growing steadily in the current quarter, with inventories at desired levels. Areas of strength are apparel, toys, home furnishings, building materials, and office and graphic reproduction supplies, where respondents report sales growth rates of 10 to 15 percent, bettering expectations. Areas of weakness include appliances, discount retailing, and footwear.

Employment is said to be either increasing or holding steady. Contacts that are increasing employment are staffing expanded operations. Most contacts report difficulty attracting help and a corresponding decline in available labor quality. Labor market tightness, however, is not translating into higher wages. Wages are said to be increasing at a 3 to 5 percent annual pace. Contacts say that they are not offering wage premiums to attract labor, with the exception of computer systems professionals.

Respondents report that competitive pressures continue to constrain their ability to raise prices. As a result, prices are either level or, in a few cases (discount retailing, appliances, and footwear), declining. Materials costs are holding steady. Most contacts say that profit margins are unchanged or increasing slightly. Increases in profit margins are attributed to efficiency improvements such as better inventory control, automation, and purchasing efficiencies. All respondents say that capital expansions are currently under way and will continue for many months. Looking forward, retailers expect steady, sustainable growth with low inflation through the first quarter of 1998.

Manufacturing

Three-quarters of the First District manufacturers contacted report that recent revenues are up from a year ago. Aircraft parts, computers and other business equipment, and furniture are showing the most rapid growth. Only a few contacts say that inventories are excessive (or insufficient) relative to the volume of business. However, some have adopted inventory management practices or production technologies that result in ongoing reductions in stocks.

Most respondents report that, overall, both materials costs and selling prices are essentially flat. Plastic resin prices have risen dramatically, however, and minor increases are reported for chemicals, metals, and cotton. Paper and furniture-grade lumber prices are said to have been more stable in recent months following double-digit decreases and increases, respectively.

Domestic employment has increased in the range of 4 to 7 percent from a year ago at one-third of the manufacturers contacted. Most others report little change in headcount. Manufacturers generally cite average wage and salary increases in the range of 3 to 5 percent. Pay increases are greater for specialized technical and marketing occupations and are being augmented by bonuses and stock options at some companies.

About one-quarter of the manufacturing contacts report capacity constraints and about one-half are making heavy capital investments this year. Investment projects are related to product introductions and productivity enhancements in addition to capacity expansions. Most of the remaining respondents describe capital spending as flat or normal.

Manufacturers generally appear sanguine about future trends. No contacts detect signs of a noteworthy deterioration in business over the next six months, and many are upbeat about opportunities to market their products or to control costs.

Temporary Employment Firms

Temporary employment firms in the First District continue to expand. Most contacts report revenues growing smartly, from the upper single digits to 50 percent annually. Respondents that specialize in technical

areas are expanding more quickly than clerical and administrative placement firms. Skilled temporary labor continues to be in short supply; wages are up 5 to 20 percent from year-earlier levels. While a shortage of talent exists across all industries, the gap between supply and demand is greatest for computer programmers, software engineers, and information systems developers. Personnel supply contacts no longer report squeezed profit margins, as the tight labor markets have forced their customers to accept higher prices.

Residential Real Estate

The residential real estate market in New England is strong, although conditions vary among the states and even among regions within each state. The number of sales in New Hampshire and Rhode Island has increased over the last year, although contacts say some areas in New Hampshire are still doing poorly. Sales in Maine have not changed significantly, but Maine is the only state reporting price increases. Massachusetts and parts of Connecticut are doing very well. Even within Massachusetts and Connecticut, however, desirable suburbs are doing significantly better than other communities. While sales of single-family homes in more expensive suburbs are quite strong, condominium sales are generally unchanged, and every state has "pockets" with stagnant sales. Prices have increased slightly in some markets, although price increases are not mentioned as a major concern. Most contacts anticipate home sales will remain steady with mild price increases in the near future.

Nonbank Financial Services

Investment management firms report that assets under management continued to increase this summer. Total industry assets increased 3 percent in June, reaching \$4 trillion, and 6 percent in July. In both months, the bulk of new sales went to stock funds. All the First District firms contacted are increasing employment. The labor market in Boston is said to be tight, particularly for customer service and technology personnel, as well as for analysts and portfolio managers. As compensation rises, most of the increases are reportedly taking the form of bonuses and other incentive pay, not base salaries.

SECOND DISTRICT--NEW YORK

The Second District's economy has continued to expand at a steady pace since the last report. Major retailers report mixed results for August; on balance, sales were close to plan. Manhattan's office markets tightened further in August, though rents remain fairly stable. Housing markets continued to show moderate improvement in recent weeks, led by a pickup in upstate New York and northern New Jersey. Regional purchasing managers' reports indicate moderate growth in manufacturing activity in August. Price pressures in the District remained modest, on balance. Finally, local banks report that loan demand picked up, while delinquency rates were little changed.

Consumer Spending

Most major retailers in the region report that sales were on to slightly above plan in August, after running well above plan in July. Compared to a year ago, same-store sales gains for August ranged from 0 to 9 percent. While most retailers report that women's apparel remains the strongest category, some contacts note that sales of home goods have picked up substantially and were running well above plan in August. The UPS strike was generally said to have a minimal impact on sales and merchandise availability; one contact estimates that the strike had a positive effect on sales, as consumers sought alternative channels to mail order.

Inventories are at satisfactory levels in most cases, though one contact reports that they are "a bit thin". Merchandise costs are said to be essentially flat, though selling prices are reported to be up slightly. There has been no noticeable increase in retail wage pressures and a modest impact, at most, is anticipated from the recent hike in the minimum wage; however, some contacts express concern about labor shortages in the upcoming holiday season.

Construction & Real Estate

Manhattan's office market continued to tighten in July, but there is still no sign of upward

pressure on rents. Midtown's office availability rate edged down to 11.0 percent at the end of July, from 11.3 percent in June; Downtown's rate fell to 20.1 percent from 21.0 percent. Over the past year, availability rates in both areas have fallen by more than 3 points, but rents have risen just 1 to 2 percent.

The region's housing market continued to improve gradually overall, though there have been some intra-regional shifts. Despite ongoing anecdotes of bidding wars on New York City co-ops and condos, a large broker that tracks apartment sales in Manhattan reports that prices retreated in June and July, after surging 20 percent in the Spring months (year-to-date, the average per-room price is up roughly 5 percent from 1996 levels). Permits for new apartment construction in New York City and its northern suburbs continued to trend up in July. More such permits have been issued since the beginning of 1996 than in the prior five years combined; however, most of these have yet to come on the market. Permits for single-family homes were steady throughout the New York City metropolitan area in July. However, homebuilders in northern New Jersey report that sales of new moderately-priced homes picked up noticeably in late August and early September; contacts also report that home remodeling activity remains exceptionally strong.

In upstate New York, new home construction remained at depressed levels in July, but sales and prices of existing homes rose sharply. While it is too early to tell if this is the start of a trend, even a moderate rise in demand may have a significant impact on the market, given the dearth of new construction in the past two years.

Other Business Activity

Regional purchasing managers report continued growth in the region's manufacturing sector in August, along with abating price pressures. Buffalo purchasing managers report that new orders and production activity accelerated in August, but that employment levels declined; purchasers also report that commodity prices stabilized, following a blip up in July. According to New York City area

purchasers, conditions continued to improve in both the manufacturing and nonmanufacturing sectors, though growth slowed from July's brisk pace; prices paid for goods and services edged down in August. During the recent UPS strike, both organizations surveyed their members on its impact; in both surveys, slightly over a quarter of respondents noted a "severe" impact from the strike, though most anticipated that deliveries would be back on schedule within a few days after the end of the work stoppage.

A major New York City employment agency specializing in office jobs reports that the labor market is "tremendously tight" and has grown progressively stronger over the past few months; last month was characterized as the "best August in our history" Still, consumer confidence in the Middle Atlantic states (New York, New Jersey, and Pennsylvania) remains well below the national average, after holding steady in August. A recent survey of large employers across the New York metropolitan area shows projected 1997-98 salary increases averaging 4.1 percent, about the same as in 1996-97. Tourism remained strong in July—although hotel occupancy rates edged down on a seasonally adjusted basis, room rates continued to run 10 percent above comparable 1996 levels.

Financial Developments

Bankers at small to medium sized banks in the Second District report stronger loan demand for all categories except consumer credit over the last two months. Demand for residential mortgages grew most notably, with 43 percent of bankers reporting stronger demand. Refinancing activity increased on net. Bankers appeared more willing to lend than they were two months ago, while credit standards were mostly unchanged, although lenders appear to be easing standards on consumer lending.

Interest rates on all types of loans declined over the last two months, but deposit rates were mostly higher. Credit quality, as measured by delinquencies, was stable to slightly improved. In particular, delinquencies on commercial and nonresidential mortgages were down, while consumer and residential mortgage delinquencies were roughly stable.

THIRD DISTRICT - PHILADELPHIA

Reports from businesses in the Third District indicated that economic activity in the region increased moderately in August. Manufacturers reported some gains in shipments and orders. Retail sales increased modestly for the month and on a year-over-year basis, although auto sales were just about the same as a year ago. Lending activity at area banks was up slightly. Commercial real estate markets continued to firm up a bit, and construction activity has increased, but not by a significant amount. Homes sales have been steady in most parts of the District, and home prices were reported to be appreciating only marginally.

MANUFACTURING

Manufacturers reported increases in orders and shipments during August, continuing on the path of moderate growth that characterized the previous two months. Firms in nearly all the major goods-producing sectors in the region were sharing in the gains, although producers of electrical machinery noted a slight drop in business. On balance, area manufacturers indicated that order backlogs were steady, even though delivery times edged up from the previous month. Some firms noted they were implementing procedures to shorten delivery times and to reduce required inventory levels. While two-thirds of the firms contacted in August said their employment levels were steady, nearly one-fourth were adding workers. These firms were primarily makers of business equipment.

Most firms contacted for this report continued to describe industrial prices as steady. Three out of four said both input and output prices have not changed from last month. More

companies noted recent increases than decreases in costs for the goods they purchase, but the number of area firms that raised prices for their own products was offset by the number reducing prices.

RETAIL

Third District retailers generally reported an increased pace of sales in August compared to July and increases over August of last year. For most of the stores contacted for this report, year-over-year gains were a bit over 3 percent in dollar terms on a comparable store basis. The increase in total sales was higher as several major retailers have expanded the number of stores they operate in the District since last year. Most apparel stores experienced healthy gains compared to last year, although stores specializing in footwear did not appear to attain the increases they had expected. In general, store executives said they entered the back-to-school shopping period with appropriate product mixes and attractive prices and they did not have to make unplanned price markdowns. They described their inventories as appropriate for the current pace of sales.

Auto dealers said sales ran at a steady pace throughout August and at about the same rate as in August of last year. Manufacturers incentives have not boosted overall sales, but they have enabled dealers to reduce inventories of current models as they begin to receive shipments of new cars.

FINANCE

Bank lending in the District has been rising slowly. Real estate lending has increased and consumer loan volume has moved up a bit. Business loan volume outstanding at commercial banks has been relatively flat in recent weeks. Bankers continue to report competition for

commercial and industrial loans from nondepository institutions such as commercial finance companies and specialized small business lenders. Real estate investment trusts have stepped up their activity in the region, and they are providing financing for acquisition of existing office and industrial buildings as well as undeveloped land. They are also financing construction of some new commercial buildings.

REAL ESTATE AND CONSTRUCTION

Commercial real estate markets in the District have been firming up since the beginning of the year according to property management firms, although construction activity has not increased significantly. Office vacancy rates have improved slightly; the rate was estimated at 14 percent in the Philadelphia central business district, around 9 percent in northern Delaware, 18 percent in southern New Jersey, and 10 percent in the Pennsylvania suburbs around Philadelphia. Rental rates have edged up in some tight markets, but the average increase in the District has been slight. Commercial real estate contacts said the current vacancy rate in the Pennsylvania suburbs has prompted some speculative construction in those markets; but demand for space in central Philadelphia has not yet pushed acquisition prices of office buildings up to replacement cost, the point at which potential acquirers of space might consider new construction. Demand for industrial space, especially distribution facilities, remained strong throughout the District, and rents have been on the rise in recent months. Some speculative construction of industrial space has begun, and commercial real estate agents think new supply could restrain increases in rents for these types of buildings.

Reports from residential real estate agents indicated that home sales in the District have been running at a steady rate recently. Realtors said the pace has been good, although lower than

in the spring. According to real estate agents and builders, both existing and new home prices do not appear to be appreciating very much. A continuing large supply of homes for sale is limiting price increases, although the amount of time homes are on the market before being sold has been declining.

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FOURTH DISTRICT - CLEVELAND

General Business Conditions

Business activity remains generally stable at a high level. However, reports of labor shortages have become more prevalent and there are a few indications that wage growth may have accelerated in certain areas and occupations.

Temporary employment agencies in the District report doing a brisk business, and virtually all note an increase in the demand for temporary workers between July and August. Several agencies indicate difficulty attracting and retaining qualified workers, with clerical and light industrial laborers in especially strong demand. Agencies also report that an increased proportion of their workers' temporary assignments are becoming permanent positions, and most see a recent step-up in wages with even larger increases anticipated in the near future. There is growing concern over a potential lack of temporary help in retailing as the holiday shopping season approaches.

Manufacturing

Industrial activity is slightly softer than at the midsummer reading, and inventory levels have come up a bit. Orders growth is good, but also more moderate than it was a month earlier. Still, manufacturers report little concern over recent trends in business activity and rate conditions as good or better.

Cost pressures continue to be light overall, with only scattered reports of higher prices for industrial commodities. Moreover, no significant labor shortages or wage increases were noted.

Consumer Spending

Retail sales picked up in the last month, building on the slightly stronger numbers seen since June. Most District retailers report year-over-year sales gains for the period. Apparel goods have been selling especially well. District contacts also indicate a year-over-year increase in furniture sales. Seasonal discounts were seen as helping to create a strong computer software market. General retail inventories are reported to be at good levels for the season, and little upward price pressure from suppliers is noted.

District auto sales have been fairly strong in the past two months—a substantial improvement from earlier in the year. Most dealers report that sales are in line with—or slightly up from—last year’s rapid pace. However, most of the recent improvement has been attributed to the generous incentives used to clear out last year’s models. New car inventories are at or near desired levels for almost all dealers surveyed. Used car sales, while improved, are still not as strong as the new car market. Several dealers report that the portion of customers with good equity and credit has risen since earlier this year.

Tourism in the District has been varied. New attractions have enhanced it, but it was hurt by cool, wet weather early this summer. Visits to campgrounds and state parks are down throughout the District, although better weather at summer’s end improved these results. Occupancy rates at District hotels were mixed, depending on their location, but were generally soft in July.

Agriculture

Recent rains have allayed concern over the District’s harvest of certain crops, but poor weather earlier in the year damaged plants and reduced yields for many crops.

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Corn and soybean yields are expected to be down from last year in Kentucky due to late planting, above-normal temperatures, and dry soil at season's end. Similar conditions are seen in western Pennsylvania. In Ohio, crops are in better shape and harvests are generally expected to top 1996 levels. Of Kentucky's tobacco, 70% is rated fair-to-good, though the real test of the harvest comes in November after the leaves have been dried.

A late freeze this spring, followed by dry summer weather, has affected some of the District's fruit crops. Apple production in Kentucky is projected to fall 25% below 1996. Likewise, the Pennsylvania Agricultural Statistics Service is forecasting a 5% decrease in the pear crop and a 21% decline in grapes. In West Virginia, 77% of cattle and calves are rated in good-to-excellent condition. The winter wheat harvest is complete throughout the District, with yields above last year's.

Banking and Finance

Lending activity in the District has been flat, or perhaps slightly down, in the commercial and consumer areas. Mortgage refinancing is characterized as moderate.

Consumer delinquencies are reported to be unchanged since the last District report. Most respondents feel the consumer debt situation has stabilized, although levels are somewhat high. Commercial delinquencies remain quite low.

The spread between borrowing and lending rates remains narrow, and some small banks report trimming costs to remain competitive. Many said they had eliminated application and ATM fees. Credit standards are reportedly tighter. Banks note that there is very little evidence of speculative home building in the District.

FIFTH DISTRICT-RICHMOND

Overview: The overall pace of Fifth District economic activity picked up in August, although growth in some sectors moderated since our last report. Manufacturing expanded more rapidly than in the June-July period, but retail and services growth slowed somewhat. Banks reported that lending activity rose modestly and that demand remained strong for commercial loans and residential mortgages. In real estate, commercial leasing activity increased further while residential activity remained mixed. Labor markets continued to be tight and wage pressures were more noticeable, especially for skilled workers. Price pressures were little changed. In agriculture, crop yield prospects diminished because of continued dry weather.

Retail: Retail activity in the Fifth District expanded at a more moderate rate in August following July's exceptional pace. Revenues increased but lacked the strong growth last reported. Retail wages again increased sharply. Retailers added fewer employees; several contacts reported increased difficulty in finding and retaining workers. One South Carolina merchant said that employee turnover had become "severe" and finding people willing to work "retailers' hours" was nearly impossible. Shopper traffic showed continued strength. However, contacts reported a rise in retail inventories and a fall in sales of big-ticket items. Some sources described increased price discounts on furniture and apparel, but otherwise prices were stable.

Services: Service-sector activity remained strong during August although revenue growth eased slightly. Employment and wages rose at a steady rate despite contacts' reports that workers were in critically short supply. Looking forward, sources were optimistic, expecting stronger demand for their services during the next six months.

Manufacturing: The pace of District manufacturing activity quickened in recent weeks as growth in shipments and new orders strengthened across most industries. Manufacturers of electronic components, furniture, paper products, and textiles said that their shipments strengthened. However, producers of chemicals, plastics, primary metals, and transportation equipment reported that their shipments weakened. A medical products company noted that its new orders fell, possibly because customers feared product spoilage because of the UPS strike. Employment and wage growth in the manufacturing sector picked up in August; however, contacts continued to express concern over the availability of qualified labor. Manufacturers again stated that raw materials costs increased at a faster rate than their finished goods prices.

Tourism: Tourist activity continued to strengthen since the last Beige Book. Contacts reported that despite a “flat” Labor Day weekend the number of tourists visiting Fifth District resorts in August increased relative to both the previous month and a year earlier.

Ports: Port activity picked up in July with contacts reporting faster growth for both import and export volumes. The share of containerized cargo shipped through District ports increased somewhat while that of break-bulk cargo edged slightly lower. Strong growth was again reported in paper product shipments, but slower growth was noted in agricultural commodity shipments.

Temporary Employment: Temporary employment agencies continued to report increased demand for labor. Most agency contacts said that finding workers for clients had become more difficult and that the scarcity of computer-skilled workers was particularly pronounced. Several agencies reported that they pay cash “bounties” to temporary workers who help them recruit others. While wage rates continued to rise only modestly in many areas

of the District, agents in cities with low unemployment rates noted an acceleration in wages. One North Carolina agent said that companies in her area unwilling to raise wages were being told they had little chance of filling open positions; she believed that these firms were “beginning to see the light.”

Finance: Lending activity in the Fifth District edged higher in August. Demand for residential mortgages and commercial loans was generally strong, and contacts continued to report keen competition for commercial accounts. Consumer loan activity remained spotty, except for a pickup in the demand for education loans. Interest rates on loans were little changed.

Residential Real Estate: Across the District, residential real estate activity was mixed. Realtors noted that customer traffic and home sales increased in August, while contractors indicated that building permits and housing starts were flat. Sales of higher-priced homes were strong in many areas of the District. Looking forward, sources expected to see further strength in sales of higher-priced homes because of recent tax law changes.

Commercial Real Estate: Since the last Beige Book, commercial real estate activity continued to expand at a moderate rate. Leasing activity across the District ranged from stable to somewhat higher; one contact echoed the sentiments of many when he stated that “there have been no big jumps, either up or down.” Vacancy and rental rates generally were described as holding steady, although contacts noted rising rents in North Carolina markets. Contacts in several areas indicated that lease terms included fewer “giveaways.” Most sources noted a further increase in construction activity, but saw little speculative building apart from Class A office space. One central Virginia realtor believed that retail space in that area was becoming overbuilt.

Agriculture: Conditions in agriculture deteriorated somewhat during the last several weeks according to analysts in that sector. Continued dry weather reduced hay production and prospective corn yields, although the impact on other crops was said to be less noticeable, and prospects for irrigated crops such as vegetables and tobacco remained favorable. In livestock, poultry production remained on the upswing despite a disease outbreak that reduced turkey output in North Carolina. Also in North Carolina, the state legislature recently enacted a two-year moratorium on new hog operations. However, industry watchers believed that swine production would likely continue to expand there because a number of hog operations were in the start-up phase prior to the passage of the legislation and were not subject to the new law.

SIXTH DISTRICT - ATLANTA

Summary: Reports from most contacts suggest that growth remains moderate across much of the District. Retail sales continue to exceed year-ago levels, but only slightly. The single-family housing market is operating at healthy levels throughout much of the District despite subdued growth in general areas. Overall, manufacturers indicate that activity is improving slightly in the District and loan demand is holding steady. The tourism industry finished up a strong summer and the outlook remains good. Reports of wage and price pressures are infrequent.

Consumer Spending: Most District retailers reported that recent sales exceeded year-ago levels. However, July's sales were much stronger than August's on a year-over-year basis. Several retailers attributed the weaker August sales to the unusually early start at many schools, which shifted purchases into July. Most retailers said that back-to-school sales had met their expectations; however, a notable minority said that receipts had been below their expectations. Overall, retailers expect third quarter sales will slightly exceed year-ago levels.

Construction: Reports indicate that recent home sales and construction activity have varied by area. However, the majority of contacts report that sales and building within the single-family market has been similar to last year in both July and August. In some places, the market is now reported to be suffering from too much inventory, but most areas continue to report that inventories are about right. Looking forward, most builders expect construction in the fall to equal last year's levels. Realtors also generally expect that third quarter sales will be similar to those of a year ago.

District commercial real estate markets remain strong. Office markets continue to improve as vacancy rates continue to drop in key District markets and construction continues at a healthy

pace. Speculative office construction is underway in several District markets. The industrial market also remains strong across most of the region; however, lack of suitable land is slowing development in several places. The weakest segment of the commercial real estate market continues to be multifamily housing. Several markets report declining occupancy rates and more use of incentives to attract new renters. However, occupancy rates and rents are expected to rebound by the first of next year, as the pace of new construction slows.

Manufacturing: Manufacturers gave mixed reports. Most of those contacted said that the U.P.S. strike caused some interruptions of production but none indicated irreparable damage. Apparel jobs continue to shrink except for firms with special niches. Nine Mississippi apparel plants have closed and more than 850 garment worker jobs have been lost in the state this year. An industry spokesman attributes most of the closings to foreign competition. A military contractor notes that the market for their defense goods remains flat. More positively, production is increasing for some paper and electronic and electrical equipment companies. The volume of shipments has increased in the chemical industry, and steel and machine shops report increasing output and sales. The average factory workweek and factory payroll are increasing for some lumber and wood product firms. Shipyards along the Gulf Coast mostly continue to report new orders and expect further increases in the coming months.

Tourism and Business Travel: Tourism finished the summer season on a strong note with high hotel and motel occupancy rates and good attendance for most regional attractions. Year-to-date occupancy rates are above those of last year for Orlando, and average room rates are up by nearly 10 percent. According to early reports, an encephalitis scare did not dissuade tourists from attending Florida's attractions during the important Labor Day holiday. Orlando

International Airport's major carriers have approved a \$1.2 billion expansion program that will allow the airport to keep pace with airline passenger growth into central Florida. The cruise industry out of Miami and Port Canaveral continues to report good results. Louisiana's 14 river boat casinos reported strong revenues in July with increased numbers of gamblers.

Financial: In the past few weeks loan demand has varied by area and type of loan. Bankers' reports on the strength of consumer and automobile loan demand are mixed. Commercial loan demand is generally reported to be flat. Mortgage lending is slightly weaker than last year but bankers expected it to increase. Consumer loan quality is reported to be holding steady.

Wages and Prices: Wages remain stable in most industries. There are a few reports of increasing material and finished goods prices but they are not widespread. Although low unemployment rates in parts of the region are making it difficult for high-tech firms and some others to find qualified employees, companies are using part-time workers and students to fill lower-level positions. Firms are also bolstering employment rolls by tapping into retirees re-entering the workforce and attracting workers with flexible work hours. Geoscientists, petroleum engineers, and shipfitters are in especially high demand along the Gulf Coast because of a resurgence in the energy and shipbuilding sectors. Price increases are limited to a few industries. Paper prices are expected to continue to increase over the next few months. Shipyards report increasing prices for raw materials as do some metal producers. However, a large chemical producer and an apparel producer note falling product prices.

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SEVENTH DISTRICT--CHICAGO

Summary. In August and early September, the Seventh District economy expanded at a slightly higher rate than in our last report. Consumer spending picked up as the weather cooled across the region and back-to-school sales met or exceeded merchants' expectations. Commercial building activity continued to lead the housing/construction sector, while sales of existing homes improved. Manufacturers continued to produce at very high levels and order books generally remained full. Bankers reported increased lending activity in most areas with the business side continuing to outpace the consumer side. While labor markets remained very tight, there was little, if any, change in wage pressures. Crop conditions improved due to recent rains, and farmland values continued to trend upward.

Consumer spending. Cooler-than-normal weather across the Midwest reportedly boosted retail sales in August and early September. Most contacts noted strong year-over-year sales gains, which exceeded their expectations. Apparel sales continued to lead the way, in large part due to cooler weather. Sales of women's apparel were particularly brisk and sales of men's and children's apparel and shoes were also strong. Back-to-school sales generally met or exceeded retailers' expectations. Home appliance sales were reported to have improved over the past two months. On average, higher-than-expected sales led to some inventory reductions, but as one merchant stated, "no one's complaining about it." Contacts reported that the Midwest continued to be one of the more competitive retailing environments in the nation. There were no reports of price increases although some chains continued to cut back on promotional activities. One large retailer noted increased profitability due to fewer promotions as well as an improvement in credit card delinquencies.

Housing/construction. Overall construction activity increased again in July and August, but the residential segment was mixed. Homebuilders indicated that sales and construction of new homes were below last year's record levels and building permit data for District states support these reports. In addition, a concrete dealers' association indicated that shipments to residential builders had slowed throughout the Midwest. Sales of existing homes, on the other hand, continued to improve over the summer. Though year-to-date sales remain below last year's record levels for most realtors, the spread has narrowed considerably in the last two months. One large realtor in the Chicago area reported particular strength at the upper end of the resale market. Momentum in nonresidential construction continued to mount in most areas. Contacts indicated

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that most of the strength was in the light industrial segment, with public works (including schools) also strong, but to a lesser extent. Materials pricing remained "flat, but firm" and there were no new reports of shortages, though one concrete dealer noted that supplies continued to be tight.

Manufacturing. Manufacturing activity continued at very high levels through the summer and orders remained strong. Composite indexes from Chicago, Detroit, and Milwaukee purchasing managers' surveys all showed activity increased at a faster pace in August than in July. Steel producers were struggling to build inventories to keep them in line with sales. One large steelmaker reported that the normal summer slowdown did not take place this year, and noted particular strength in demand from the construction, oil and gas, and machinery industries. Automakers reported that inventories of both 1997 and some 1998 models were low, on average, and expect third quarter production to outpace that of the second quarter. The short supply of some 1998 models was due, in part, to lingering effects of earlier labor strikes as well as normal delays associated with major model changeovers. Demand for heavy trucks and over-the-road freight-handling equipment was reported to be strong and order backlogs were increasing. Demand for heavy equipment (land moving, mining, agricultural, etc.) remained very strong and exports to Latin America and Europe were reported to be increasing. One heavy equipment producer noted that orders had tapered off somewhat recently from very high levels, but this may be a result of orders being placed earlier in the year by some of their customers. Inventories of most heavy equipment remained low, yet pricing was flat. An already competitive pricing environment for most manufacturers had become more intense with the strengthening dollar. As in our last report, prices for inputs were reported to be flat to down.

Banking/finance. Overall lending activity picked up on a seasonally adjusted basis in August and early September with the bulk of the strength on the commercial side. A contact at one of the region's larger banks stated that "lending activity continued to surprise on the upside." Bankers around the District noted that the normal late summer slowdown had yet to materialize, echoing reports from contacts in other industries. Loan volume for commercial real estate continued to increase, particularly in the light industrial segment. One large bank expressed concern that lenders were lowering credit standards somewhat for commercial mortgages, a concern that was noted by a contact in another metro area in our last report. Consumer lending continued to soften slightly. Home mortgage lending was mixed, with activity increasing for existing home loans but decreasing for new homes. Asset quality on credit card loans was reported by one large institution to have improved slightly, but this contact also indicated that this

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improvement may be temporary. One large card issuer indicated that promotional activity targeting households with excellent credit ratings had increased recently. Overall standards for consumer loans continued to tighten somewhat. Most indicated that the tightening has been gradual, "not a knee-jerk reaction, but slow and steady." None of the institutions contacted indicated any deterioration in asset quality in the past few weeks.

Labor markets. Labor markets remained very tight throughout the District while employment growth continued to lag the nation's. The average unemployment rate was below 4 percent in July for the third straight month and there is no indication that it has risen from there. Roughly one-third of the District's metropolitan areas had seasonally adjusted unemployment rates below 3 percent for the month. (The Madison, Wisconsin area has been below 2 percent since December 1994.) In addition, analysts from state agencies indicated that claims for unemployment benefits over the last six to eight weeks nearly mirrored last year's very low levels for the same period. Staffing agencies noted that order backlogs for the industrial segment of their business continued to rise in most areas. Reflecting strength in nonresidential building, demand for construction workers (which normally starts to taper off at this time of year) remained very strong. In a national survey, Midwest firms reported their strongest fourth-quarter hiring plans since 1978, with the durable goods manufacturing and construction industries leading the way. There were no new reports of wage pressures intensifying, although shortages of workers persisted in most areas. A small business association representative reported that entrepreneurs, who two years ago were clamoring to buy fast food franchises, are now eager to sell because they can't find or retain productive workers.

Agriculture. Crop-condition ratings for most District states improved slightly in recent weeks as adequate moisture helped sustain plant growth. Nevertheless, recent reports suggest dry weather in late July may have caused more yield losses in some areas than originally thought. In general, crop development was slightly ahead of the average pace of recent years. However, it will likely be early October before crops in northern portions of the District reach maturity and are safe from frost damages. Our latest survey of District agricultural banks found that farmland values continued to trend upward, but at a somewhat slower pace than in recent quarters. Farm loan demand continued to be strong at surveyed banks during the second quarter reflecting, in part, the continuing strength in farm machinery and equipment sales. However, the availability of funds for making farm loans reportedly tightened somewhat, reflecting higher loan-to-deposit ratios and the increased presence of other farm lenders.

EIGHTH DISTRICT - ST. LOUIS

Summary

Economic growth in the Eighth District appears to have accelerated somewhat. Retailers report a pickup in consumer spending during July and August, boosted by back-to-school sales that generally met or exceeded expectations. Car dealers are optimistic that sales, bolstered by the 1998 models, will increase through the end of the year. Most other District business contacts also report that their sales have met or exceeded expectations. A further tightening of already tight District labor markets is expected in the fourth quarter, according to the latest Manpower survey. District residential real estate markets are starting to experience an excess supply of available houses, especially higher-priced ones. Loans outstanding continue to increase at large District banks. Recent rains in mid- to late-August, while beneficial to the District's soybean crop, probably came too late to help the corn crop.

Consumer Spending

District retail contacts report that July and August sales were up 4 percent on average over one year ago. Back-to-school sales generally met or exceeded expectations; athletic shoes, sportswear and professional team clothing were the biggest sellers. A few contacts noted, however, that sales of other merchandise have been somewhat sluggish. Inventories are at desired levels, making retailers less likely to offer discounts to move merchandise. Most are optimistic about sales for the rest of the year, particularly during the holiday season.

On average, July and August car sales were up about 3 percent over one year ago. Many dealers have indicated that used car sales continue to be strong, but, for the most part, are not affecting new car sales. Most dealers are optimistic about sales during the rest of the year, particularly now that many 1998 models are available.

Manufacturing and Other Business Activity

The general sentiment among most District contacts is one of optimism. They report that sales

have generally been stronger than forecast at the start of the year—a trend they expect to continue through the end of the year. For the most part, District contacts continue to report no unusual acceleration in input prices or slowdown in supplier delivery times. Most contacts report that increases in raw materials prices have recently averaged less than 2 percent; steel and shipping cartons have seen the largest price hikes. One contact commented that some of his input prices have fallen, and he is negotiating to keep these prices steady for next year.

A contact in the timber industry says that demand is on an upswing, and several new mills have opened in southern Arkansas to meet this higher demand. A furniture industry contact reports that sales are somewhat stronger than last year, a record year for his company. A telecommunications firm announced that it will open a new information technology center and a credit and collections center in the St. Louis region, bringing about 1,200 jobs by next year. A contact in the steel industry reports that it will add new capacity in northeast Arkansas and create about 100 new jobs.

The District's apparel industry, however, is taking another large blow. Fruit of the Loom announced it will lay off about 2,000 workers by October from two plants in southern Kentucky, bringing employment down to 5,000 from 11,000 just two years ago. At the same time, Fruit of the Loom will increase employment by about 300 at a Mississippi plant by December because of expansion. A contact in the paper industry reports that it is suffering from excess capacity worldwide, causing production slowdowns at local plants.

Outlook

A recent survey of 225 small businesses in the Eighth District suggests a moderation in output price pressures. About 17 percent of surveyed firms expect to boost their selling prices over the next three months, which is about a percentage point lower than three months earlier and 2.5 percentage points lower than 12 months earlier. Manpower's most recent employment survey indicates that a significantly higher percentage of firms in Little Rock, Louisville and Memphis plan to hire workers in the fourth quarter than planned to in the third quarter, putting further pressure on already tight labor markets. Still, wage

pressures appear to have moderated slightly, as a little more than a quarter of the aforementioned small firms reported increasing wage rates over the past three months, which is modestly lower than the nearly one-third reported in the same survey a year ago.

Real Estate and Construction

Monthly residential construction permits in June picked up in only four of the District's 12 metropolitan areas. Permit levels in all District metro areas except Evansville and Memphis remain below year-ago levels, which were record highs. Several contacts have noted an excess inventory of available housing, particularly houses selling for more than \$200,000. Nonresidential construction remains strong in many parts of the District, particularly in the gaming region of northwest Mississippi. One contact, though, noted that both multi-family housing and retail construction have likely peaked in the District.

Banking and Finance

Total loans on the books of large District banks rose 1.2 percent from mid-June to mid-August, compared with a 0.6 percent decline during the same period one year ago. Business loans rose 0.9 percent, while real estate loans increased 0.3 percent. Consumer loans, the smallest of the major loan categories, fell 1 percent.

Agriculture and Natural Resources

Significant rainfall during mid- to late-August helped ameliorate the extraordinarily dry conditions in many locales. Despite this much-needed rain, the consensus is that it occurred too late to help the corn crop. The rains, however, appear to have helped the District's soybean crop considerably. Likewise, in the Delta region, contacts report that prospects for this year's cotton crop look much better now than they did earlier this summer. Pockets of unusually dry areas persist, though, particularly in Missouri and parts of southern Illinois and western Kentucky.

NINTH DISTRICT--MINNEAPOLIS

The mood is upbeat as the Ninth District economy wends from summer into fall. Consumers are flocking to the malls and appear more willing to travel than earlier in the summer. New homes and other buildings are sprouting up across the region, and manufacturers' orders are swelling. The western portion of the region is getting a lift from a boomlet in oil and gas exploration and from the recent improvement in livestock prices, while in the eastern portion most areas are looking for a good corn and soybean harvest. This vigor in the economy is taxing the ingenuity of employers as they scramble to find workers in the region's tight labor markets, but so far the district has avoided a marked acceleration in wages.

Amid the region's current prosperity, however, some soft spots persist. Tourist spending was disappointing in some areas, consumption of the district's iron ore has dropped, and the wheat and other small grain harvest is expected to be disappointing in many areas.

Consumer spending and tourism

"Very pleased," "phenomenal" and "strong" are how managers at three of the region's largest shopping malls term recent consumer spending at their malls. Moreover, two Minneapolis-St. Paul based retailers, which have been experiencing financial difficulties, reported double-digit year-to-year sales gains in August.

Furthermore, the district started to shrug off some of the sluggish tourist spending plaguing the industry earlier. Since mid-July inquiries at a Montana tourism office have been "hopping," helping to offset the slow start at Glacier and Yellowstone parks and other Montana tourism venues early in the summer. The Upper Peninsula of Michigan also had a slow start, but in July and August tourist spending was up about 5 percent from a year ago, according to a tourism official. In South Dakota, however, summer tourist spending was slower than expected, with visitations at many of the major attractions down from a year ago.

Automobile dealers are less euphoric: "holding their own" and "all right" are terms association executives use to describe recent sales.

Construction and real estate

“Everyone is wondering when it’s going to slow down,” says an industrial property financier, commenting on the 6.4 million square feet of industrial space in the Minneapolis-St. Paul area either under construction or planned. This is up 60 percent from 4 million square feet completed in the 12 months ending in April. In South Dakota, the dollar value of publicly awarded contracts for private building from January through July is up 59 percent from a year ago.

Moreover, residential building shows signs of reviving. In July Minneapolis-St. Paul area housing units authorized by building permit were up 2 percent from a year ago; from January through July they are down 17 percent from last year’s high levels.

Manufacturing and business services

“We have good orders,” says a Minnesota specialty electronics manufacturer. “Business is very solid,” reports a North Dakota machining business. Such reports are common, and good revenue reports by publicly traded manufacturing firms and year-to-year manufacturing employment gains across the region in July confirm them. Reflecting investors' confidence in the region’s manufacturers, Minnesota venture capital firms “pumped a record \$92 million into 60 deals during the second quarter of 1997, eclipsing the old mark by \$25 million,” reports a Minneapolis-St. Paul newspaper. Most of the firms financed were medical technology or other high-tech manufacturing ventures. Small manufacturing firms reportedly are also doing well in cities in eastern North and South Dakota.

The current strength in manufacturing is more than offsetting recently announced layoffs and shutdowns in the region. Noteworthy is the shutdown this summer of a South Dakota pork processing plant employing 850 workers.

Natural resource industries

Oil drilling remains strong and paper production is recovering, but iron mining is slowing. Montana has 12 rigs drilling, the highest level in years, and the 19 rigs in North Dakota continue the 18 month mini-boom in oil and gas exploration and development. After a slower-than-normal 1996 due to a drop in paper prices, a major Minnesota paper producer indicates its production would increase about 18 percent in 1996 and 1997, and is planning

a \$30 million dollar equipment upgrade. But U.S. iron ore consumption this year is down from a year ago, which is cited as a reason for recent layoffs at mines in Minnesota and the Upper Peninsula of Michigan.

Agriculture

Improving livestock prices have district livestock producers gearing up to expand output. Ranchers are building their breeding herds as females as a percentage of the total cattle slaughter are below year-ago levels both regionally and nationally. Dairy producers, however, are squeezed by high forage costs, but some producers anticipate moderate price increases in coming months.

Meanwhile, “the corn is excellent,” reports a southern Minnesota banker, reflecting the positive outlook in the corn-soybean areas of eastern South Dakota, southern Minnesota and western Wisconsin, where good yields and favorable prices are expected. But where wheat and other small grains predominate, yields vary greatly, and prices are less favorable than for corn. “We are going to have an average crop,” says an ag loan officer in eastern North Dakota. Sugar beet producers expect an average crop.

Labor markets

A banner towed by an airplane over the Minnesota State Fair beseeched fairgoers to apply for work with a car rental agency. This initiative symbolizes considerable efforts many employers are taking to attract workers in the district’s tight labor markets. Many Minneapolis-St. Paul employers, especially fast food operators, express frustration about the difficulty of securing needed workers, and tight labor markets remain a problem in cities in the eastern Dakotas, Minnesota and western Wisconsin.

As employers scramble for workers, reports of higher pay for many specialties, bonuses and nonwage increases in compensation are increasingly common. In South Dakota, which has one of the nation’s lowest unemployment rates, hourly earnings in manufacturing are up about 5 percent from a year ago in July compared to 1.5 percent the previous 12 months. No marked general acceleration of wage increases, however, is yet apparent across the region.

TENTH DISTRICT - KANSAS CITY

Overview. The district economy continued to grow moderately last month.

Manufacturing activity remained strong, retail sales increased, and energy activity improved further. Construction activity generally held steady. In the farm economy, the corn and soybean crops were in good condition, the cattle industry benefited from favorable prices and good pasture, and hog producers continued to expand. Labor markets remained tight in much of the district, with some limited evidence of wage pressures. Prices generally held steady at the retail level and for most manufacturing and construction materials.

Retail sales. Retailers report sales increased last month and were higher than a year ago. Sales are expected to increase moderately in the coming months. Retailers are generally satisfied with current stocks but expect to expand inventories in the next several months in anticipation of the holiday season. Automobile dealers report sales edged up last month and were generally unchanged from a year ago. Sales of light trucks, sport utility vehicles, and imported passenger cars remained particularly strong. Some dealers report shortages of popular models, and most plan to expand stocks in the next several months to meet an expected increase in sales.

Manufacturing. Manufacturers continued to operate at moderately high levels of capacity last month. Manufacturing materials were generally available, with lead times unchanged. Manufacturers have been trimming their inventories slightly, and some say they plan further reductions in the coming months. A quarterly survey of district manufacturers indicated that production, shipments, and new orders all increased modestly in July, at a pace slightly slower than earlier in the year.

Housing. Builders report housing starts held steady last month and were generally

unchanged from a year ago. Builders expect construction activity to remain stable over the next several months. Sales of new homes were down slightly from the previous month and unchanged from a year ago. Most building materials were readily available and delivery times were normal. Mortgage lenders say demand edged up last month.

Banking. Bankers report that loans edged up and deposits fell last month, boosting loan-deposit ratios slightly. Home equity loans and residential construction loans both increased, while other loan categories were flat. Large CDs and small time and savings deposits fell, outweighing increases in NOW accounts and MMDAs.

Almost all respondent banks left their prime lending rates unchanged last month, and most expect to hold rates steady in the near term. Most banks did not change their consumer lending rates and anticipate no future changes. A few banks tightened their lending standards, citing concerns over credit quality.

Energy. District energy activity continued to improve last month and remained somewhat stronger than a year ago. Crude oil prices and natural gas prices both increased but remained well below the peaks reached at the end of last year. The district rig count rose 4 percent in August to a level 24 percent higher than a year ago.

Agriculture. The district corn and soybean crops appear to be in good condition, but crop development is behind schedule. Concerns have now turned toward the possibility of an early frost, which would likely damage the corn and soybean crops substantially. However, if the weather pattern is normal, district producers should harvest a record soybean crop and an above-average corn crop.

Operators of cattle feedlots in the district have maintained slim profit margins. A steady

pace of marketings has helped support fed cattle prices, but prices could be forced down as more cattle are slaughtered this fall. Feeder cattle prices have leveled out recently after rising most of the past year. Feeder cattle prices could continue their upward trend later this year due to the small calf crop going to market this fall. With good pasture conditions throughout the district, many ranchers plan to hold calves until the spring of 1998. Many large hog producers continue to expand their operations in the district, and the increase in supply has led to lower hog prices. Still, continued growth in pork exports is keeping prices at profitable levels.

District agricultural banks report their loan portfolios are stronger than a year ago. After a downturn in the district farm economy in 1995 and 1996, many banks are optimistic about the improving financial condition of their borrowers, especially wheat and cattle producers.

Wages and prices. Labor markets remained tight last month in much of the district, with some limited evidence of wage pressures. Retailers say qualified entry-level workers were hard to find, and manufacturers report difficulty hiring production workers and skilled craftspeople. A few companies say they raised wages more than normal to attract or retain workers, but most say wage increases were about normal. Employers report they are becoming more creative in job recruitment, and some say they are compensating workers in new ways--for example, by shortening the time it takes a new hire to reach the top of the pay scale. Prices held steady at the retail level and for most materials used in manufacturing and construction. Retailers expect no major price changes in coming months.

ELEVENTH DISTRICT--DALLAS

Eleventh District economic activity expanded in August, leading many contacts to express optimism about the outlook for the remainder of the year. Labor shortages continued to be reported, boosting wages in a few industries. Office rents and some energy and other product prices were higher. Demand grew at the same pace or increased for most manufacturers. Retail sales picked up, and demand continued to increase for services. Construction activity grew at a moderate pace, boosted by strong growth in commercial construction. Bankers said demand for financial services was unchanged. The energy industry continued to report strong demand and profits. Crop and livestock conditions were generally good.

Prices. Labor shortages continued to be reported and were boosting some wages, mostly at business service and energy firms. But several industries were fighting off wage increases by finding creative ways to increase worker satisfaction without raising wages or costs. Nearly all firms reported that the minimum wage increase was not binding. Office rents continued to rise, leading to a stratification in some markets—firms splitting their offices between high and low rent locations. Some manufacturers reported that problems with rail shipments had pushed up costs, but most were not passing on this higher cost to product prices. Logging restrictions had boosted some lumber prices, such as maple and southern yellow pine. Paper producers reported an increase in the prices of liner board, boxes and pulp, but no change in the prices of paper bags. One contact noted that memory chip prices had resumed falling recently after stabilizing some in the 30 days prior to the last survey.

Strong demand and tight supplies placed upward pressure on energy prices in August. Any disruption in normal delivery conditions, due to mechanical problems or weather, was immediately reflected in higher energy prices. Natural gas prices were pushed up by strong demand for current consumption and for storage to meet winter demand. Strong demand and tight supplies kept oil prices

near \$20 per barrel. Gasoline prices remained high--driven partly by a series of mechanical problems at large refineries and by a shortage of additives to produce clean-burning summer gasolines--but are expected to begin a seasonal decline soon. Ethylene capacity continued to be tight, but upward pressure on the selling price of ethylene and some other petrochemical products was restrained because large amounts of new capacity had come on line or is scheduled to come on line in the fourth quarter.

Manufacturing. Demand grew at the same pace or increased for most manufacturers. Demand was up for construction-related materials, such as metals and lumber, particularly to supply commercial builders and the mining sector. Strong demand and summer shutdowns had led to low inventories of steel. Telecommunications and electronics manufacturers said that demand growth had been steady since the last survey, and the outlook was positive. Semiconductor manufacturers said demand remained moderate but somewhat below trend. Producers of food and kindred products reported that sales were stable, although weaker than expected. Reports from apparel manufacturers were mixed, with some reporting increases in demand while others saying that demand had been very soft. Demand for petrochemicals remained strong. Domestic refiners responded to strong demand with high levels of production, reaching record high levels of capacity utilization for several weeks this summer. Each mechanical outage sent gasoline prices soaring, which sharply improved margins because crude prices remained stable.

Services. Demand continued to increase for business services, such as accounting, consulting, legal and temporary staffing services. Demand for these services was broad-based across industries, including demand from banking, manufacturing, small high-tech companies and information-technology consulting. Air cargo, trucking and railroad companies all reported very strong demand. The outlook was positive in all service industries, although there were some concerns about the availability of labor.

Retail Sales. Retail sales picked up and several contacts said that sales were stronger than expected. Retailers did not report any inventory problems. Some retailers said that their markdowns were not as large as at this time last year, raising final selling prices. Retailers were optimistic about the outlook

for the remainder of the year and, as one retailer added, the outlook is "optimistic realistically so, not just wishfully so."

Financial Services. District bankers continued to report steady demand for financial services. Bankers said that competition remained stiff, keeping pressure on loan rates. Delinquency rates remained low, according to contacts.

Construction and Real Estate. Construction activity grew at a moderate pace in August, boosted by strong growth in commercial construction. Office occupancy rates continued to rise in major metro areas. Industrial vacancies are low but expected to rise as new construction is completed. Continued strong demand for apartments is expected to lead to increased apartment construction in the second half of the year. Existing home sales were up strongly in the past 6 weeks.

Energy. Oil service and machinery companies continued to report strong demand and profits. In August, the U.S. rig count exceeded 1000 for the first time since the Persian Gulf War in 1991. Contacts expect Canadian drilling to reach record levels as well, further boosting demand for District services and machinery. Shortages of oil-related equipment and potential employees with industry experience have become a chronic problem, pushing up prices of equipment and labor. Contacts believe a shortage of crews will limit drilling activity.

Agriculture. Crop and livestock conditions were generally good. Harvest of the Texas corn crop is nearly complete, and reports indicate the crop is excellent. Texas is expected to harvest record high production of corn and peanuts, as well as large cotton and soybean crops. The cool, wet planting season combined with the summer's extreme heat has reduced this year's cotton yields, however.

TWELFTH DISTRICT — SAN FRANCISCO

Summary

Twelfth District contacts reported vigorous economic activity in the recent survey period. Retail sales picked up in most areas, and service providers maintained high levels of activity. Durable manufacturing output continued to expand rapidly. Sales of most District agricultural and livestock products were high. Commercial banks performed well, and lively conditions prevailed in real estate markets. Respondents continued to report strong competition for highly skilled workers and some respondents noted a tightening market for entry-level workers. However, respondents reported very little upward pressure on the prices of final goods and services.

Business Sentiment

Survey respondents expect somewhat faster national and District real economic growth during the next year. Slightly over half the respondents expect national economic growth to exceed its long-run trend rate, a higher percentage than in any previous survey this year. Nearly a third expect lower unemployment, which also is a higher percentage than in recent surveys. In a continuation of recent response patterns, however, nearly half the respondents expect inflation to rise over the next year, and virtually none expect a decline. A large majority of District contacts continue to expect growth in their respective regions to outpace national growth.

Retail Trade and Services

Retail sales grew at a solid clip in most areas, with particularly strong growth reported for Southern California and Arizona. Sales of sporting goods and soft goods such as clothing were above their levels earlier in the year. In Utah, however, slowed housing purchases reportedly

reduced sales growth for related retail items, and overall retail sales were “soft.” Throughout the District, retail prices for clothing and pharmaceuticals were largely unchanged, and retail prices for food (particularly dairy products) declined. Among consumer durables, sales of new automobiles were at or below the high levels achieved in 1996, and prices remained largely unchanged. Retail inventories generally were stable at moderate levels, except in Utah, where slower sales growth produced rising inventories.

Conditions for District service providers were solid overall. Thriving business conditions in most areas spurred rapid expansion by providers of media and communications services. Demand for electricity and natural gas was held down somewhat by mild weather in the District; this combined with supply factors to cause stable or declining prices for both energy sources. In contrast, respondents in California and Oregon noted rising prices for health care. Tourist traffic increased noticeably in Southern California but slowed somewhat in Utah, Nevada, and Hawaii, in the latter due largely to a drop off in foreign visitors. Some service providers reported tightness in the market for entry-level workers.

Manufacturing

District manufacturing activity expanded further in the recent survey period. This sector’s strength was largely attributable to rising demand for durable products such as aluminum, machine tools, computer equipment, and aircraft. Respondents from this sector continued to report strong competition for highly skilled workers. In contrast, sales and prices of wood and lumber products were held down by declining foreign demand and rising imports. Among nondurables, one Southern California respondent reported that growth in demand for pharmaceutical products slowed, and another noted that clothing manufacturers in Los Angeles encountered “slight” labor

shortages. One respondent reported downward pressure on export prices associated with currency devaluations in Southeast Asia, and several noted that stiff competition in product markets held down manufacturing price increases in general.

Agriculture and Resource-related Industries

The quantity and quality of District agricultural output were high. West coast fruit, vegetable, and nut sales were very good, particularly in California. Although concerns about tainted beef temporarily slowed sales, cattle suppliers did well overall, with strong domestic demand bolstered by rising exports to Mexico and Southeast Asia. In contrast, a late season decline in crop health exacerbated the adverse effects on growers of reduced demand for Idaho potato products.

Real Estate and Construction

Real estate markets and construction activity continued to surge in many areas of the District. Home prices rose in California as a whole, with significant sales increases in the southern and central portions of the state. Commercial vacancy rates fell to extremely low levels in downtown San Francisco, but sales prices for commercial properties reportedly remained low, and there was little new construction. Residential and commercial markets tightened further in Oregon and Washington, with yearly home price inflation estimated at 5 to 10 percent in parts of the latter state. Home prices also increased noticeably in the area around Anchorage, Alaska. In contrast to most of the District, residential construction and sales have slowed in Utah.

Financial Institutions

District banking conditions strengthened further in the recent survey period. Conditions improved noticeably in Southern and Central California, with stepped-up loan growth and

improved credit quality. Although strength in the equities market held deposit expansion down, banks reported ready availability of funds throughout the District.