SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS BY FEDERAL RESERVE DISTRICTS

March 1986

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SUMMARY*

Moderate economic expansion has continued in most regions of the country in recent weeks, despite unevenness across sectors. Recent improvements in economic activity are noted by New York, Cleveland, Kansas City, and Philadelphia. Richmond and Atlanta report sustained growth at a relatively strong pace, while Minneapolis and Boston indicate mixed conditions with no clear direction for the overall economy.

The major sectors of strength included construction and selected manufacturing industries. Although industrial activity varied across Districts, general improvements were noted for energy-intensive manufacturers such as the lumber, paper, aluminum, and steel industries. Both commercial and residential construction continue strong in most Districts, with several reports noting benefits from falling mortgage interest rates. Major economic weaknesses continue to be concentrated in the agricultural and energy-producing sectors, and further deterioration is anticipated because of continuing price declines, especially for oil. Consumer spending growth, although characterized as moderate, was noted in nearly all Districts.

Industry

Industrial activity appears mixed, according to District reports. Solid improvement in manufacturers shipments and orders was reported by Cleveland in contrast to substantial declines earlier. Philadelphia reports continuing healthy increases in orders but little change in employment. Orders are improving for both the aluminum and steel industries, according to Cleveland and Chicago. Boston reports increased orders for manufacturing products related to housing, and signs of an upturn for the forest products industry are reported by San Francisco, Cleveland, and Richmond. In contrast, Minneapolis reports mill closings due to continuing imports of forest products

*Prepared at the Federal Reserve Bank of Atlanta.

from Canada. The aerospace industry is prospering. The steep drop in oil prices has stimulated energy-intensive industries, according to Atlanta. Although chemical firms have yet to benefit from lower prices for petroleum based inputs, producers are optimistic about the outlook. Richmond states that textile producers' workweeks are increasing and inventories are favorable.

Other Districts continue to show declines in industrial activity. Large scale cutbacks in manufacturing employment were cited by New York, and staff reductions related to business mergers and cost containment programs are noted by Chicago. Manufacturers' inventories are reported to be tolerable, and there appears to be little upward pressures on prices.

Minneapolis, Dallas, San Francisco, and Atlanta report further weakness in their energy sectors following recent declines in oil prices. Minneapolis reports rig counts in North Dakota at the lowest level in five years, and Dallas reports a 30 percent reduction from last year's depressed levels. In Alaska, where oil revenues contribute 85 percent of state revenues, the Governor has already taken steps to reduce state spending.

Consumer Spending

There was widespread agreement among commentaries that consumer spending was up moderately in January-February from year-earlier figures. Consumer goods inventory levels across much of the country tended to be lean and under control. Boston reported that sales were somewhat volatile, in part because consumers are promotion-minded. "Cautious" consumer spending was reported by Chicago and New York, with the latter attributing it to uncertainty over the course of the economy. As usual early in the year, sales of nondurable goods tended to outpace durables. Dallas suggested that declining seasonally adjusted housing activity also contributed to relative weakness in durable goods sales there, and that sales in energy-dominated regions were rising less than in other areas. Kansas City reported some unwanted inventory build-up at retail with slightly reduced prices as a consequence, while Boston noted that prices of imported goods are rising. The outlook for tourism in the Southeast has improved as a result of discount airfares, according to Atlanta.

Auto sales are apparently showing varied temporal and geographical results. Atlanta's report of volatile activity, related to waves of limited-time cut-rate financing deals, was a typical commentary. However, Cleveland reported fairly strong and stable growth of sales, while Kansas City, Dallas, and San Francisco reported flat, disappointing, or declining auto sales.

The dominant range of outlooks for overall consumer spending and for autos, particularly, seems to be moderate-to-bright. Philadelphia reported that retailers are raising their sales forecasts. Exceptions are those areas most adversely affected by declining energy prices, where spending growth prospects are considerably dimmed.

Construction

Residential real estate markets are generally strong, and most Districts report some improvement in both sales and construction. The notable exceptions were in the Dallas District, where residential activity declined due to the uncertain regional economic outlook, and in the New York District, where cold weather, snow, and a labor shortage have slowed construction. Atlanta reports severe residential real estate weakness in Louisiana, which shares the energy sector problems of the Dallas District.

Commercial construction also continues strong generally, although it is clearly weakening in the Dallas District. Atlanta noted a significant shift of commercial construction resources away from offices and stores toward light industrial buildings.

Financial Services

Although reports vary among regions, the nation's total loans continued to increase in recent weeks. Dallas, Richmond, and Philadelphia indicate an increase in total loan growth, while Atlanta reports that the decline in growth in its region was checked for the first time in almost a year. New York, Philadelphia, and San Francisco reported that declining mortgage rates are sustaining mortgage volume and boosting the rate of refinancings. There are indications of declining or softening commercial lending at Dallas, Kansas City, and Atlanta and weaker consumer lending at Cleveland and St. Louis, the latter probably due to competition from auto dealer special financing packages.

Agriculture

Most of the farm sector remains under heavy financial pressure resulting from large crop supplies and weak demand, which have continued to reduce market prices of most farm commodities. Depressed returns prevent heavily indebted borrowers from meeting scheduled loan payments, and farm foreclosure rates are rising principally throughout the areas of field crop production. Kansas City reports that from 6 to 10 percent of farm borrowers will be denied credit this spring. The Farmers Home Administration has mailed notices of potential foreclosure to 40 percent or more of their borrowers in several states in the Southeast. Minneapolis reports a banker's projection that one-third of indebted farmers in South Dakota will eventually leave farming. San Francisco relates that in addition to low prices and heavy import competition, some orchard producers suffered severe losses from recent flooding. On the brighter side, Richmond and Atlanta point out that poultry producers are doing relatively well with firm prices, expanding output, and falling feed costs contributing to growing profits. Conversely, Dallas indicates beef cattle feeders are stressed by depressed cattle prices and declining marketings.

FIRST DISTRICT-BOSTON

The pace of economic activity in the First District is quite unbalanced. Retail sales are expanding modestly, according to plan. The manufacturing situation is mixed, with some responders experiencing a softening in order rates and others, most notably those in housing-related areas, enjoying an upturn. The residential real estate boom continues. Perhaps the most notable development in this month's report is the divergent import price experience of manufacturers and retailers. While manufacturing respondents have not observed any appreciable increases in the prices of imported components and materials, several retailers have seen very substantial increases in import prices. These increases will appear in prices to the consumer in a month or so.

Retail

Retail sales in the First District in January and February were generally consistent with plan, but contacts reported an increase in volatility. Inventories are also according to plan for most merchants contacted. Several firms expressed concern about consumer acceptance of projected price increases for imported goods resulting from the decline in the dollar.

Aside from one chain experiencing a downward sales trend, contacts report moderate sales growth in January and February, about at planned levels. Several contacts said consumers are becoming even more promotion-minded, with sales revenues swinging widely in response to advertising and perceived value. For example, a home furnishings chain reported that sales rise in a predictable way for major promotional events, but that the traditional correlation between sales and new home production has disappeared.

Inventories were reported to be as planned. Firms with increasing sales have been increasing inventories to support them while the one contact with weak sales has been reasonably successful in keeping inventories in check.

Prices are reported to be stable except by firms with considerable imports. One respondent cited a 30-35 percent increase in costs for selected home furnishing items from Europe. The firm is concerned that consumers will balk when these price increases are passed on in the next month or so.

First District merchants expect moderate but not robust sales growth in 1986. Warehouse expansions and store openings continue on schedule, but several contacts said they will be more comfortable after a few months of steadier growth.

Manufacturing

Reports from the manufacturing sector are mixed. Some respondents have experienced a softening in orders relative to a year ago, while others have enjoyed a pickup. Orders for housing-related products and communications equipment are rising. According to one respondent, demand for housing products is increasing daily. Sales of both capital equipment and supplies to the U.S. automakers are holding up well. Sales to the machine tool and apparel industries, on the other hand, are disappointing; respondents attribute the poor sales to the effects of foreign competition on their customers.

Respondents continue to encounter strong resistance to price increases, except when they have a unique product. Prices of purchased materials and components, including imports, are well behaved. For this group of manufacturers, the most important effect, to date, of the decline in the value of the dollar has been to make the earnings of foreign subsidiaries appear more attractive. However, one contact from the machine tool industry reported that a colleague had received a number of orders from Europe as a result of the dollar's decline and another contact reported that European shoe producers are finding it more difficult to sell in the United States.

Most respondents will spend as much or more on plant and equipment in 1986 as they did in 1985. Employment levels are expected to be fairly steady.

Real Estate

The residential real estate market in the Boston metropolitan area is very strong. Housing prices, which increased about 70 percent over the past two years, are still rising. In a number of communities prices are said to have risen 5 to 10 percent just since the end of 1985. Realtors attribute the sharp rise in prices to the strong economy and tight supply. Home production is up, but has not kept pace with demand - in part because of limited building space and no-growth attitudes in many communities. The greatest growth in housing has been in the outer suburbs to the west and southwest of Boston. The housing market is also said to be strong in southern New Hampshire and the Providence area.

In commercial real estate, many new office buildings have recently been built in the Boston suburbs and more are coming on-line. Absorption rates have been healthy, but so much space is available that the vacancy rate has reached 20 percent and developers expect it to go higher. Demand and supply are more in balance in downtown Boston, where the vacancy rate is about 10 percent. While a lot of new space has been added, the percentage increase was not as large as in the suburbs. Because Boston's vacancy rates are still lower than those of other major cities, developers from other parts of the country are becoming interested in Boston. At the same time, some Boston developers are beginning to look at other New England cities. Providence and Hartford are said to have vacancy rates of about 15 percent. Vacancy rates in southern New Hampshire are about 25 to 30 percent but some developers find the area attractive because absorption rates are high and there is a lot of land available to develop.

SECOND DISTRICT--NEW YORK

The Second District's economy improved somewhat in recent weeks. Department store sales were moderately higher than a year earlier, resulting in generally satisfactory inventory levels. A pickup in office leasing activity was noted in a number of areas, and homebuilding remained strong where weather permitted. Reports on business activity were mixed, however, and several manufacturers announced sizable cutbacks. Small banks in the District have not yet adjusted mortgage rates to reflect the latest sharp declines in market rates.

Consumer Spending

During the first two months of 1986, District consumer spending grew only moderately from year-earlier levels, more or less in line with retailers' expectations. As a result, inventories were generally reported close to target.

Bad weather during the February President's Week promotions was cited as a factor in the moderate performance of District department stores. Moreover, some retailers believe consumers spent cautiously because of uncertainty over the course of the economy. Also, several stores noted that consumers seem to be increasing their buying at small specialty and discount stores, leading to lower sales at the department stores.

Business Activity

Second District business conditions continued mixed in recent weeks. Buffalo purchasing managers reported a marked increase in new orders and in production during January, following a slowdown in December. However, managers in Rochester noted the opposite pattern. The percentage of Buffalo firms with higher inventories also rose somewhat, but by far the majority of purchasing managers in both cities reported inventories at stable or lower levels.

While some plant expansions and new projects were announced, plans for large-scale employment cutbacks by District manufacturers have recently dominated the news. By the end of March, Eastman-Kodak will have terminated 1200 jobs in the Rochester area over a three-month period. By year's end, Kodak plans a 10 percent reduction in its worldwide workforce from the 1985 level. A full 10 percent decline in Kodak's Rochester employment would mean the eventual elimination of 5400 jobs there. Also in Rochester, a GM unit has announced a possible reduction of 1500 workers as it changes from making carburetors to producing a less labor-intensive fuel system. In addition, while GE plans to hire 270 workers for a new subway repair shop which will begin operating in the Buffalo area by July, it also will eliminate some 1500 jobs at a Schenectady plant because of depressed demand for the turbines and generators produced there. (In February, the unemployment rates of 6.8% in New York State and 5.9% in New Jersey remained below the national average.)

Construction and Real Estate

Homebuilding in the District has slowed somewhat due to cold and snow, but a good deal of activity continues on structures with foundations laid earlier. In Manhattan, where an unusually large number of multifamily units was started to qualify for local tax benefits before they expired in November, a shortage of structural wall laborers is currently reported due to the high level of building activity. Throughout the District, builders expect 1986 to be another good year following the record level of housing starts in several areas during 1985.

High or rising levels of leasing activity are reported in office markets throughout the District, and improving occupancy rates are anticipated. Despite a softening market for downtown Manhattan office space, observers are encouraged by the resurgence of residential and retail development in the area. However, in midtown Manhattan, an oversupply of such space is prompting caution on the part of lenders. In Fairfield, Connecticut fewer new office projects are being undertaken because of concerns that a shortage of affordable housing will limit the county's ability to attract new office tenants.

Financial Developments

Mortgage rates at small Second District banks have been trending down for several months, but they do not yet reflect the sharp drop in market rates since mid-February. Fixed rate mortgages are still in the 11 to 12 percent range but are expected to come down in the near future. The consensus among bankers is that the expectation of further rate declines is keeping mortgage demand relatively constant and forestalling any sizable shift out of adjustable rate mortgages. Refinancings account for as much as 40 to 50 percent of business at some banks, but this percentage has been relatively stable over the past few years.

THIRD DISTRICT - PHILADELPHIA

The Third District economy is healthy, on the whole. Business continues to improve in the manufacturing sector, although order backlogs and employment have edged downward slightly in recent weeks. Retail sales in January and February were in line with or above merchants' expectations, and unplanned discounting was minimal. Bankers report continued growth in lending, although not at the rapid rate of increase of early 1985.

The outlook for the next six months is generally positive. Manufacturers expect continued improvement, although they do not foresee any near-term increase in employment. Retailers see no signs of slackening consumer demand, and they are raising their sales forecasts for the first half of the year. Bankers predict steady growth in commercial and consumer loan demand, as well as mortgage lending at current interest rate levels.

MANUFACTURING

Industrial activity in the Third District is expanding marginally, according to the latest Business Outlook Survey. Twenty-three percent of the firms replying to the March survey say their business has picked up from a month earlier while 13 percent say business is down. Sixty-four percent of the survey respondents report no change. Conditions are substantially the same for manufacturers of durable and nondurable goods.

Third District manufacturers have increased shipments, but made only slight gains in winning new orders; the level of unfilled orders has dropped fractionally. Employment rose at 10 percent of the plants covered by the March survey but declined at 25 percent, thus offsetting last month's slight gain.

Prices of industrial goods are steady in the region. More than 80 percent of the companies surveyed report no change in the prices of either goods purchased or goods sold this month.

Optimistic views prevail among the local manufacturers participating in the latest survey. More than 40 percent forecast continued expansion and look forward to increases in new orders and shipments over the next six months; another 40 percent expect a continuation of present conditions. Employment prospects are not as bright, however; most manufacturers surveyed in March do not expect any change in payrolls or working hours between now and autumn.

RETAIL

Third District retailers say sales during January and February ran above the same period a year ago. One major department store reports sales up by nearly 8 percent over January-February 1985, and a retailer with stores throughout the Third District says an upgrading of product lines has been very successful. Most products are selling well, including appliances, which had not been strong performers during the Christmas shopping season, and stores have not had to take unanticipated markdowns to maintain post-Christmas sales.

Third District retailers contacted in March have raised their sales forecasts. They expect the strength exhibited by most product lines in January and February to continue. Although sales of spring merchandise have been restrained by cold weather recently, merchants are carrying sizable inventories of these items in anticipaton of strong sales once warmer weather takes hold.

FINANCE

Total loans outstanding at large Third District banks in February were approximately 10 percent higher than a year earlier. A dip in commercial and industrial loans outstanding in late January and early February had been recouped by the beginning of March, according to lending officers. Third

District bankers expect the current economic expansion to continue throughout 1986, providing the impetus for growth in business lending of 10 percent or more during the year.

Commercial leasing has declined substantially. Local bankers do not expect this business to revive unless proposed tax changes, which have negative implications for leasing, are modified, or the date of their implementation is postponed.

Although consumer lending is still moving up, the rate of increase has eased at Third District banks. Automobile manufacturers' incentive financing programs have taken installment lending market share from banks. Growth in credit card loan volume has been slowed by seasonal repayments of credit balances by consumers as well as by more cautious lending by Third District banks in response to rising delinquencies. Mortgage lending is brisk, both for refinancings and home sales.

Third District bank deposits are increasing at about the same rate as they did during 1985, with growth relatively stronger in money market deposit accounts and longer-term CDs. With slower growth in loan portfolios than last year, banks are committing a larger portion of new funds to money market instruments than they did in 1985.

Local bank economists are raising their forecasts of economic growth in response to the drop in oil prices, a depreciating dollar, and a sustained high level of consumer demand. Nevertheless, they do not expect much upward pressure on interest rates until later in the year. Most economists anticipated the recent cuts in the discount rate and prime rate. As for long-term rates, they expect Treasury bonds to remain at 8 to 8.5 percent. Rates are expected to rise by year-end, however, with short term rates up about 30 basis points and long term rates up about 50 basis points.

FOURTH DISTRICT - CLEVELAND

Summary.

This District's economy continues to improve. Retail sales are rising but not robustly. Unemployment rates have fallen but remain high, especially in Ohio. Manufacturers report signs of strength, but pockets of softness remain. Some oil wells are being closed because of weak prices. House construction, sales, and mortgage refinancings are being stimulated by falling interest rates. Banks are optimistic about business loan demand, but their consumer loan growth is slowing.

Consumer Spending.

Consumer spending in this District continues for the most part to mirror national economic trends. Major retailers report nominal sales roughly 4% to 7% above year-ago levels. Household nondurable goods and apparel sales are particularly strong, which is typical for the season. Although most retailers categorized their February inventory positions as "manageable," inventories appear to be somewhat above year-ago levels.

District auto dealers express growing optimism about their 1986 sales prospects, and report that sales to date are good. Surprisingly, local auto-sales data have not reflected the monthly volatility characteristic of the national auto market. During the first two months of 1986, unit sales of domestically made new cars in this area were nearly 5% above year-ago levels. Most auto dealers, including some import dealers, report that new-car inventories are high.

Labor Market Conditions.

The Ohio and Pennsylvania unemployment rates (s.a.) fell in February to 8.7% and 7.1%, respectively. Ohio's unemployment rate continued on its path of erratic monthly changes, dropping in February because employment rose while unemployment was essentially unchanged. Pennsylvania's unemployment rate continued its downward trend as employment rose while unemployment fell.

Manufacturing.

Manufacturing activity in this District shows solid signs of improvement after several months in the doldrums. New orders and production are rising but not yet robustly. Despite this good performance, employment at manufacturing firms continues the slow decline of the past four or five months. Firms also continue to reduce raw materials and finished goods inventories. On balance, manufacturing firms report paying slightly higher prices for raw materials. A few contacts report that dollar depreciation has begun to increase their export sales or increase the prices they pay for imported materials. Carbon steel prices are reported to have begun to firm and some industry representatives expect the industry profit/loss results to be better this year than last. Some strength also is reported for the aluminum industry. Nevertheless, a great deal of softness remains in many parts of this District; for example, one contact reports concern that a major manufacturing plant may shut down temporarily because of weak orders.

Energy.

Some oil wells in southern Ohio are being closed because of weak prices and because buyers are reluctant to purchase oil when they expect further price cuts. Gas production remains good in southern Ohio. Some slight declines in steam coal prices are being reported, but a major producer reports that the price of coal is quite insensitive to falling oil prices. In many locations coal is still relatively cheaper than oil, and very large capital costs are required to convert a coal-fired boiler to oil-fired so conversions won't be made unless oil prices are expected to remain low for an extended period.

Housing and Construction.

Realtors, mortgage lenders, and builders in this District expect the current strength of housing markets to be sustained throughout 1986, but they are skeptical of the rosier national forecasts.

Mortgage lenders report that falling mortgage rates have prompted a deluge of mortgage refinancings by borrowers with high rate fixed-rate mortgages or adjustable-rate mortgages, generating substantial fee income for the lenders. They expect the strong demand for fixed-rate mortgages to persist, particularly as the gap narrows between rates for adjustable-rate and fixed-rate mortgages. Fifteen-year mortgages are popular despite the higher monthly payments.

Housing and commercial construction is doing very well in some parts of this District, although there is some concern about overbuilding. A major home builder doubts that a building boom will result from the evolving single-digit interest rate environment because there is little pent-up demand for housing and lower interest rates are needed merely to keep housing activity at current levels.

Realtors report closings surged in February and the inventory of listings is declining to a low level. Most realtors have no plans to add staff soon because they are wary about how long and strong the housing market rebound will remain.

Commercial Banking.

Business loan demand at District banks is improving. Commercial and industrial loans outstanding at large banks continue to increase. Loan commitments are generally up, and contacts are fairly optimistic about future loan demand. Consumer installment lending remains good but the rate of expansion has fallen. Consumer installment credit outstanding at large banks is growing at only a single-digit pace. Bank installment lending continues to be hurt by cut-rate auto loans being offered by captive finance companies of domestic auto manufacturers.

FIFTH DISTRICT - RICHMOND

Overview

Economic activity in the Fifth District, on average, remains moderately strong. There are, however, many booming areas, such as the Research Triangle area in North Carolina and suburban Washington, as well as depressed areas such as West Virginia. Consumer spending has not shown signs of accelerating, and reports of increasing delinquencies on installment debt are beginning to appear. Manufacturing, on the whole, is steady. Single-family housing appears to be the strongest segment of the construction industry. High inventories are depressing prices and expected production for several crops; the demand for poultry products, however, is high and growing.

Consumer Spending

Consumer spending in early 1986 has not been as robust in most areas of the District as many observers had wished. Two executives from major department stores noted that January and early February sales were flat, and they were concerned about the success of spring promotions. It was noted, however, that some specialty stores in the District had fairly strong sales gains. A furniture manufacturer also noted lackluster retail sales in January and early February. A survey of directors revealed that none saw rapid growth in consumer spending in their own areas, a few saw little or no growth, and most saw moderate growth. Projections for tourism in the Carolinas call for further gains in 1986.

Manufacturing

In contrast to 1985, inventories of textiles and textile products are, on the whole, tolerable, and are not putting severe pressure on manufacturers to cut production and employment. Although employment is not increasing, some evidence of an increase in the length of the workweek is beginning to surface.

The strength of the housing market has begun to affect the lumber industry. Mill orders for products made from southern pine have increased in January and February from levels in the fourth quarter of 1985.

Also, a chemical producer expressed guarded optimism concerning the outlook for the chemical industry in 1986, due to low oil prices and rising growth in Europe. In South Carolina, several new manufacturing plants have recently been announced, including plants owned by Pirelli, Mack Trucks, and United Technologies. In general, manufacturers' inventories in the District appear to be in line with sales.

Construction

Concern continues to be expressed about the potential for overbuilding in office space in several areas of the fifth District. Also, vacancy rates of apartments appear to be rising in some, but not all, areas of the District. Single-family housing has recently been strong in many localities in the District, with observers noting the possibility of even stronger growth in 1986 in response to recent declines in mortgage interest rates. Demand for residential mortgages is high, due to the strength of home sales and the refinancing of existing mortgages.

Financial Institutions

Most directors associated with financial institutions are seeing rising delinquencies of consumer installment debt. A few directors are also noting higher delinquencies for revolving credit and home mortgages. The volume of lending is following the national pattern, with large increases over year ago levels.

Agriculture

Inventories of most crops, including peanuts, corn, wheat, and soybeans, are very high, resulting in downward pressure on prices (excluding some seasonal increases). Corn production in the District will not necessarily decline, however, due to strong demand from poultry raisers. Also, in North Carolina, it is estimated that growing corn will be profitable for many producers, due to low production costs. Production of cotton, however, is likely to be unprofitable due to declining demand from textile mills. High inventories are putting downward pressure on peanut prices. Weak export demand for tobacco is also evident.

Cattle prices are at unusually low levels. Producers of pork and beef products are expected to benefit from lower grain costs, however.

The poultry industry is the bright spot of District agriculture, with production high in 1985 and expected to rise in 1986. Per capita chicken consumption is expected to rise by two pounds in 1986. Turkey production is also rising. Scattered outbreaks of avian flu, however, concern poultry producers in the District.

SIXTH DISTRICT - ATLANTA

Economic activity in most sectors of the Southeast sustained the stronger pace that emerged around the turn of the year. Reductions in borrowing costs and prospects for substantial declines in energy prices have begun to stimulate regional industries, and employment has been growing. With some exceptions, residential and commercial construction activity remain strong. With regard to commercial space, building continues despite high office vacancy rates. The outlook for tourism has improved, and regional airline traffic has responded to declines in fares and prospects of further cuts. Consumer spending has moderated. Many of the region's crop farmers are delinquent on their loans, though prospects are better in a few selected agricultural areas.

Employment and Industry. Unemployment rates fell moderately in most District states from December to January. Florida and Georgia continue to post below-national jobless rates. Alabama and Tennessee are slightly above the nation, but continued weaknesses in energy and agriculture have kept rates in the double-digit zone in Mississippi and Louisiana. The region's paper producers have trimmed excessive inventories to near-normal levels, and plant operating rates have begun to climb. Sawmills are being helped by declining energy prices and imports of low-cost timber from Canada. Lower oil prices are expected to stimulate demand for petrochemical products by lowering costs and prices. Home appliance producers in Alabama and Tennessee are encouraged by the better housing situation. In contrast to declines for other textile producers, Georgia carpet mills have added 2,700 workers over the year in response to strong demand for carpets used in automobiles, offices, and homes.

Consumer Spending. Retail contacts report that sales in early 1986 are only moderately higher than a year ago. Most respondents also report a continued tight inventory stance in an effort to control costs more closely in an environment where profit margins are narrow. Although merchants expect only a slight improvement in March compared to last year, mild optimism prevails for the second quarter. Changing manufacturers' incentives are credited with getting 1986 auto sales off to a weak start compared to last year.

Construction. In most of the region, construction and sales of single-family housing remain firm to good. However, severe weakness is evident in Louisiana's markets, and several large Florida markets exhibit growing softness. Multi-family building has begun to concentrate in the stronger leasing markets. Apartment vacancy rates continue to rise in most areas as new construction outpaces absorption.

Office vacancy rates remain high throughout the Southeast, yet construction continues in many markets. In those markets where office construction is dropping off, light industrial space seems to have grabbed the attention of developers. Overall, construction of retail space has attracted little new interest, and the market for industrial and warehouse space is also sluggish. All sectors of nonresidential construction are facing a slowdown in the New Orleans area, and the continuing decline in oil prices dashes hopes of any turnaround in the near future.

Financial Services. Loan growth at large District banks held steady in January after almost a year of consistently slowing growth. The strength of real estate and consumer lending balanced January's softer business loan demand. In February Alabama passed a regional interstate banking law which will become effective in July 1987. Now four of the six District states have interstate laws, including Alabama, Florida, Georgia, and Tennessee. Of the remaining two states without such laws, Mississippi currently has a bill in the state legislature, and a bill is expected in Louisiana when the legislature convenes in April.

Tourism. Data for airline passengers, auto travel, and lodging receipts indicate strong early-year performance, and contacts continue to hold positive outlooks for the remainder of 1986. Throughout the Southeast hotel/motel industry personnel are looking for an increase in domestic travel and occupancy rates due to the dollar's decline relative to currencies of most other advanced economies. There are also predictions of increased foreign travel to the United States, particularly Latin Americans to Florida. Advance convention bookings are looking good in most District markets. Regional air travelers have recently experienced much cheaper air fares, and, with the intended acquisition of the region's second largest airline by a confirmed discount carrier, air travel costs seem likely to drop further.

Agriculture. Financial conditions remain precarious for the Southeast's heavily indebted crop farmers. Thirty-five percent of the region's borrowers from the Farmers Home Administration (FmHA) are delinquent on their loans compared with 20 percent for the nation. Mississippi and Georgia are the second and third ranking states nationally in number of FmHA delinquencies. About half (over 3,700) of Georgia's FmHA borrowers and around 40 percent of such borrowers in Florida, Mississippi, and Louisiana are delinquent on payments, and most have been mailed notices of potential foreclosure. In sharp contrast to most other farmers, poultry and vegetable producers are doing relatively well. Reduced feed costs have raised profit margins for broiler growers, while the prospective returns to Florida's winter vegetable producers are being boosted by increased acreage, with prices averaging about one-fifth above the year-ago level.

SEVENTH DISTRICT--CHICAGO

Summary. Reports from respondents and other information indicate that moderate overall expansion in the Seventh District continues. The plunge in oil prices and the recent sharp drop in interest rates (which some analysts believe is related to lower oil prices) are contributing to favorable expectations regarding the economic outlook. Chicago purchasing managers reported a healthy upturn in orders and production in January and February, but not in employment. Commercial and industrial electric power usage in the region has been on an upward trend since last summer, breaking the sluggish trend of recent years. Construction activity continues at a vigorous pace in portions of the District, notably the Chicago area and southeast Michigan, but is soft in other areas, particularly in Iowa, primarily an agricultural state. Demand for motor vehicles remains strong, but will require ongoing incentive programs. Orders for steel are improved. Employment growth in this region continues to trail the nation. Heavy emphasis on cost containment, merger-related staff reductions, and plant closings have restrained hiring and caused layoffs, in a wide range of industries. Agriculture remains depressed. Farmers are confused over details of the recent farm legislation.

Labor Markets. After more than three years of expansion, payroll employment in the District is 3 percent below the late 1970s, with only Wisconsin higher. Manufacturing in the five-state region is 21 percent below 7 years ago, with Illinois down 27 percent. Numerous firms in various industries continue efforts to increase efficiency and competitiveness, by controlling costs, often through layoffs. Mergers and acquisitions often bring job cuts as positions deemed duplicative are eliminated. In some cases, job cutbacks result from work being shifted abroad. Examples include processing of manufacturers' coupons in Iowa and manufacturing of material handling equipment in Michigan. Announcement of 3,300 jobs to be filled at Mazda's new Michigan plant brought 110,000 requests for applications. Temporary layoffs to control inventories have recently been announced in railroad equipment and farm equipment. Permanent job cuts, often following earlier staffing reductions, have recently been reported in various industries including steel, trucking, farm equipment, medical technology, hospitals, communications gear, chemicals, and gas transmission. In some cases, job cuts are associated with shutdowns of production facilities.

Plant Closings. Producers of several lines of heavy capital goods in the District are responding to feeble recoveries with temporary and permanent plant closings. The leading producer of locomotives will cease production for two months at its main plant in the Chicago area and lay off 2,000 because of slack orders. An extended summer shutdown is planned at an Iowa farm equipment plant. Permanent plant closings are planned by a maker of home videodisc equipment, a manufacturer of parts for transmissions, and a producer of heavy forgings. A major producer of material handling equipment will shift one-third of its manufacturing overseas, and permanently close plants in Michigan, which had been its main facilities. In contrast, a large maker of construction equipment cancelled plans to shift certain output abroad, due to a more favorable cost picture at home. Threatened phaseout of auto assemblies at an Illinois plant was averted as a labor pact was reached after hard bargaining.

Nonresidential Construction. The office building boom is continuing in downtown Chicago. Despite an apparent glut of space, announcements of major new structures still appear. Soil testing work, in advance of construction, also continues at a good pace, despite concerns that contracts were being shifted from 1986 into 1985 to grandfather current tax treatment, and would slacken after the turn of the year. The pace of office building is reported to be slackening somewhat in suburban areas where it has been strong. Highway renovation definitely will be at a high level again in 1986, because funds are set aside, and work is sorely needed.

Home Building. Spurred by sharply lower mortgage interest rates, home construction is expected to remain at a high level in many parts of the District in 1986, relative to the early 1980s, though still well short of peaks in the 1970s. The upturn has been particularly vigorous in southeast Michigan, while activity in Iowa has been slipping. Demand for existing homes is strong in some areas, and realtors complain of a paucity of listings. The move-up share of the market has been larger than earlier in the expansion. A heavy volume of refinancing of existing mortgages at lower rates is underway.

Steel. District steel producers report improved orders and output. Demand from motor vehicle makers is in line with that industry's high production schedules. Activity has been very strong at steel service centers, which are doing more processing and holding more inventory for customers. User inventories are low and expected to rise. Prices are firming but remain low. Imported steel prices have risen, but much less than would be indicated by the fall in the dollar. Price increases will be reflected in steelmakers' revenues gradually as existing contracts expire.

Motor Vehicles. Vigorous car production plans, bolstered by a new round of sales incentives from major domestic automakers, promise a high level of activity at District assembly plants and parts suppliers in 1986. Forecasts for motor vehicle demand in 1986 generally call for a decline in total sales from 1985, and an increase in import market share. Japanese renewal of their quota on auto exports to the U.S. at last year's level supports this projection. A leading District producer of motor homes has sharply increased production, partly because of completion of an inventory adjustment in 1985, and partly in anticipation of increased demand resulting from lower gasoline prices.

Consumer Spending. Major chain stores in the District report 1986 sales ranging from small declines to modest increases. Retailers blame weather problems, high consumer debt levels, and generally cautious attitudes for the anemic performance of sales. The sharp drop in oil prices since late 1985 should bolster consumers' discretionary income, and may tend to raise forecasts for consumer spending.

Agriculture. Prices of farm commodities important in the District have trended lower since mid-January, pressured by seasonally large supplies and weak demand. Corn and wheat exports will decline again this year, probably by more than current USDA forecasts. Soybean exports, however, are rising. Exports will benefit eventually from lower U.S. support prices, lower oil prices, and the lower value of the U.S. dollar. A flurry of late Congressional actions created confusion over details of various federal farm income and price support programs. Farmers must decide whether to participate in these programs within the next few weeks, as planting decisions are finalized.

EIGHTH DISTRICT - ST. LOUIS

Summary

The Eighth District economy continues its moderate expansion. District retail sales growth exceeded national trends while employment and nonresidential construction trailed national performance. The outlook from business and academic contacts throughout the District is generally favorable, suggesting the expansion will continue at a modest pace during 1986.

Outlook

Slightly more than 80 percent of the 265 District small businesses surveyed in January expected business conditions to be unchanged or better through July. Less than a quarter of the respondents foresaw a decline of their real business volume through April, while 44 percent expected an increase. Despite this generally favorable outlook, only 19 percent thought the period was a good time to expand. Most of the respondents expected no changes in their prices, work force or average compensation through April. These responses reflect little change in the expectations of District businessmen since the last survey was conducted in October 1985.

A forecast by the University of Arkansas indicates the Arkansas economy will grow faster than the nation in 1986, spurred by increases in manufacturing, trade and services employment. A forecast for Tennessee economic growth in 1986 was less optimistic with nonagricultural employment predicted to grow by only 1.9 percent. Employment declines in the manufacturing and mining sectors are expected to contribute to the state's sluggish growth.

Consumer Spending

District retail sales increased at a 4.8 percent rate in the fourth quarter while a 3.7 percent decline was reported nationally. December retail sales in the District were 21.8 percent above year-ago levels, exceeding the 6.7 percent national gain. Extremely strong December sales in Kentucky were largely responsible for the District growth.

Employment

Employment growth in the Eighth District continues to trail national trends. District nonagricultural employment increased at a 0.6 percent annual rate in the fourth quarter compared to a 3.5 percent rate of growth nationally. Despite a December increase, District manufacturing employment decreased at a 0.9 percent rate in the fourth quarter while no change was reported nationally. The District unemployment rate dropped from 8.3 percent in November to 7.9 percent in December.

Construction

District residential construction contracts grew by 3.3 percent in the fourth quarter while nonresidential construction declined by 3.6 percent. Residential contracts, while 6.0 percent above year-ago levels, trailed the national increase of 14.0 percent. Over the same period District nonresidential construction declined by 12.2 percent compared with a 2.0 percent national increase.

Banking and Finance

February data from large District banks indicate distinct changes in lending trends that have persisted over the past year. Commercial lending, which had been sluggish, showed a reversal in February with volume growing at an annual rate of 34 percent compared to a sharp decrease last February. Consumer lending, which has shown strong growth over the past year, declined at a 5 percent rate in February.

After approval by the Missouri Senate, a regional reciprocal interstate banking bill awaits House approval. The bill has no provisions for transition to nationwide banking. The Mississippi Senate has approved a bill allowing statewide banking in 1986 and regional interstate banking in 1988.

Agriculture

In response to the lower loan rates of the 1985 farm bill, futures prices for the new crops of major District commodities such as corn and cotton are significantly lower than futures prices for the old crop. Given these price expectations for the coming year, participation by farmers in the government's price support programs is likely to be high, leading to large government stocks of agricultural commodities. Analysts in Kentucky expect further declines in tobacco prices associated with falling demand and continued large surplus stocks.

NINTH DISTRICT - MINNEAPOLIS

Aided by lower interest rates, conditions in much of the Ninth District have stabilized early this year. Consumer spending, employment, and construction have all done fairly well. Construction has been generally strong, and many new construction projects are planned. Conditions in the resource-related industries, however, are still mixed, and only a little improvement was evident in the agricultural sector.

Consumer Spending

Retail sales of general merchandise in the district have done fairly well so far this year. After experiencing strong year-end holiday sales, one diversified retailer reports reasonable sales growth in January, traditionally a slow month, and even stronger sales in February. In addition, the retailer notes that the sharp growth in credit sales, a cause of concern in some quarters, finally slowed late in 1985. Reports from large shopping malls in Sioux Falls, South Dakota, have been encouraging, with strengthening sales also evident in February. Growth in retail sales has not been uniform throughout the district, however. For example, Bank directors from northern and central Minnesota note lackluster sales in their communities.

Despite some slowing late in February, motor vehicle sales have been good so far this quarter. One domestic manufacturer reports that its districtwide sales were up about 15 percent through February, although it has a large inventory of cars and trucks available.

Spurred by lower mortgage rates, housing activity has picked up in district areas with stable or growing populations. Compared with year-earlier levels, residential building contracts awarded in January were up 12 percent in Minnesota and up 19 percent in the Minneapolis-St. Paul metro area. January home sales in the Twin Cities area were also up a healthy 12.2 percent from a year ago. In parts of North Dakota and in Sioux Falls, South Dakota, existing home sales appear to be up this year.

Employment

After worsening somewhat in the last half of 1985, employment conditions have stabilized in some district areas but have worsened in others. The district's overall seasonally adjusted unemployment rate fell a few tenths to 6.5 percent in January. In South Dakota, January employment was virtually unchanged from its January record level a year earlier. The typical seasonal employment decrease between December and January was the smallest there since January 1976. In North Dakota, though, unemployment was up, primarily due to lower employment in the oil and construction sectors. Although seasonally adjusted employment in Minnesota increased between December and January, the unemployment rate still rose; however, part of the increase was probably due to some changes, made in December, in how the rate is measured.

Resource-Related Industries

Conditions in resource-related industries in the district have remained mixed. The drop in oil prices has continued to slow district oil and gas activity. A Bank director reports that the rig count in North Dakota was down to its lowest level in five years--22 rigs (compared with 150 at its peak). In contrast, the falling dollar bodes well for district paper production. In Duluth, Minnesota, financing is now arranged for a big new paper mill, and another paper mill in northern Minnesota is modernizing its plant. But a Bank director reports that wood pulp logging for paper mills in the

Upper Peninsula of Michigan has been hurt by imports, and a lumber mill in Montana has closed. An iron pellet plant in northern Minnesota is reopening in March, but with over 100 fewer workers than were originally employed there. A reopened copper mine in the Upper Peninsula is now hiring workers.

Construction

Construction activity in the district has generally been strong, and many new projects have been announced. Nonresidential building contracts in January were up 5 percent in Minnesota since January 1985. Bank directors report numerous ambitious construction projects in the works. In and around Duluth, Minnesota, several projects--including a large paper mill, a mall expansion, and expansions of several public facilities--are expected to bring $500 million of construction activity to that hard-pressed area. Noteworthy future projects in South Dakota include a convention center and hotel in Pierre and a new community to house B-1 bomber personnel in the Rapid City area. North Dakota also expects to benefit from $200 million in military-related construction, in connection with nuclear missiles.

Agriculture

Little improvement was seen in the district's agricultural sector in the past months. Bank directors report little change in conditions in their areas. One banker in South Dakota thinks that a third of the indebted farmers there will eventually leave farming, although not all this year. On a brighter note, a Bank director reports that the winter wheat crop in Montana looks good. And prices of farm goods have increased some recently. The Minnesota farm price index rose again in January, although it still remained 9 percent below its year-earlier level. Livestock prices have deteriorated, however, even though ranchers have kept herd sizes small.

TENTH DISTRICT - KANSAS CITY

Overview. Both current economic activity and the economic outlook have improved recently in the Tenth District, apart from the difficulties of the agricultural and energy sectors. Retailers report improved sales and expect further increases. Auto dealers remain optimistic about 1986 sales. While inventories of materials inputs are generally satisfactory, some retail inventories are still viewed as too large. Most area homebuilders expect further increases in housing starts, as mortgage demand increases with further rate declines. Tenth District banks report increased deposits but little change in loans. Agricultural lenders continue to deny credit to a significant proportion of farm borrowers.

Retail trade. The outlook for sales, prices, and inventory purchases appears bright. Retailers report moderate to strong increases in sales over year-ago levels and flat to slightly improved sales over the last three months. Women's apparel and fine jewelry sales have been strong. Sales are expected to rise moderately through 1986. Prices have been reduced slightly and are expected to stabilize. Inventory levels are satisfactory to heavy, leading retailers to expect steady to slightly reduced inventory purchases for the remainder of the year.

Automobile sales. Although auto sales are below year-ago levels, dealers are optimistic about 1986 sales. Good credit market conditions are helping auto sales. Most dealers report adequate inventory levels, although some report that inventories are too high.

Purchasing agents. Most purchasing agents surveyed experienced a slight increase in the prices of their major inputs over the year ago period, and they expect prices to increase by 2 to 4 percent during the remainder of 1986. Although some firms are satisfied with current materials inventory levels, most have been trimming inventories in recent months.

Housing activity and finance. Area homebuilders report that starts of single family dwellings have increased over the year ago period, while multi-family starts have declined. Sales of new homes are above year ago levels, and new home prices have remained steady. Most area homebuilders expect housing starts to increase slightly during the remainder of this year. Housing materials availability is good, prices are steady, no slow delivery problems are reported, and these conditions are expected to continue throughout the year.

Savings and loan institutions give mixed reports regarding current savings inflows relative to a year earlier, but they expect savings inflows to increase slightly during the next quarter. Mortgage demand has increased, primarily because the demand for refinancing has increased. Mortgage demand is expected to increase further during the upcoming spring and summer home buying season. Mortgage rates have been declining, and most respondents expect rates to remain at their current level or fall a little further. Most savings institutions have not taken advantage of the opportunity to reduce the minimum deposits on MMDA's, Super NOW accounts, and 7-31 day CD's.

Banking. Total loan demand was mixed and total deposits were higher at Tenth District banks compared with a month earlier. Consumer loans, commercial and industrial loans, residential real estate loans, and agricultural loans were generally constant. Commercial real estate lending decreased at most of the banks surveyed. Tenth District bankers did not change their prime rate during the last month, but more than half of those surveyed expect their prime rate to fall in the near term. Most respondents either lowered their consumer loan rates during the last month or anticipate lowering those rates in the near future. Total deposits rose at Tenth District banks, with MMDA's and seasonal increases in IRA's and Keogh accounts leading the way. Most respondents report higher or unchanged levels of large CD's. NOW accounts and small time deposits typically were constant. Passbook savings accounts and demand deposits were unchanged or lower.

Agriculture. Many commercial lenders in the district have nearly completed credit reviews of their farm borrowers, but the results are mixed. On average, bankers reported that 6 to 8 percent of their farm borrowers will be denied credit this spring, a percentage at least as high as a year ago. However, bankers in some states said a lower percentage of their farm borrowers would be denied credit, apparently because a large number of bad loans were written off during the past year. Farm Credit System outlets in the district are less than halfway through their credit reviews, but reported that perhaps 10 percent of their farm borrowers will not get credit this spring. Both the Farm Credit System and commercial banks referred more of their farm borrowers to the Farmers' Home Administration (FmHA) than a year ago. Because it is extremely difficult to qualify for direct loans from FmHA, referred borrowers have been encouraged to apply for FmHA loan guarantees.

All lenders surveyed had acquired a substantial amount of farm real estate through foreclosure. Most bankers reported that they would sell acquired property if they could do so without taking a loss. Only a few lenders said they are selling land as soon as possible after foreclosure, regardless of price. Others expressed concern about "flooding the market." In the meantime, many banks are leasing acquired farmland.

ELEVENTH DISTRICT--DALLAS

The District economy continues a slow expansion, although the recovery is threatened by the recent precipitous drop in oil prices. Oil and gas drilling is declining rapidly. Sales by manufacturers are slipping, overall, but demand has expanded in a number of industries. The value of construction contracts is falling. Retail sales growth has been modest and auto sales have declined. The rate of loan growth at large District banks is ebbing. Prices for District agricultural commodities are falling.

District manufacturers report mixed conditions, but declining orders from the construction and energy sectors have caused overall demand to fall. Sales by primary and fabricated metals producers are shrinking because of reduced orders from construction and energy-related firms. Although a slowdown in District construction has led to reduced sales by manufacturers of lumber and wood products and stone, clay, and glass, construction demand outside the District has dampened the decline. The fall in the dollar has allowed domestic producers of electronics, glass, and apparel to compete more effectively against foreign producers and sales have expanded in those industries. Electronics and transportation equipment producers continue to benefit from increasing defense contracts, but respondents report increased uncertainty about future growth in orders. Increased world production of crude oil has expanded output at District refineries. Chemical firms, however, have not yet observed lower prices for petroleum-based inputs.

Construction activity is declining in response to rising vacancy rates and to uncertainty over the economic outlook for the District. The largest drop has been in nonresidential construction, but residential building is also declining. The value of nonbuilding construction contracts, including those for streets and highways, continues to grow rapidly.

District energy exploration, drilling, and extraction activities are on the decline. In January, the District drilling rig count was 30 percent below the already-depressed level of a year earlier. Drilling permits, a leading indicator of drilling activity, had shown evidence of reaching a floor, but the recent hard fall in oil prices has led to expectations of additional reductions. Another leading indicator of drilling activity, the seismic crew count, has been dropping steadily.

Retail sales continue to expand at a slow pace. Rates of increase vary widely across the District. Sales in energy-dominated regions are rising less than in other areas. The strongest retail sales growth is taking place in apparel and fashion lines. Sales of consumer durables are weak, partly because of their close link to housing sales, which have been declining in the District. Retail respondents report that they are trying to hold their inventory-to-sales ratios at very low levels.

After several years of brisk auto sales respondents are reporting declines in sales. The largest reductions are in the energy-dominated portions of the District. Inventories are rising to undesired levels and price competition has intensified. Although some popular models are in short supply, the overall availability of automobiles is greater than at any time in the last two years.

At the District's large banks, growth in total loans increased slightly in January, compared to last year's fourth quarter pace. The year-over-year rate of expansion, however, remains considerably below the average gains during the first three quarters of 1985. The volume of business loans fell absolutely. Real estate loan growth has slowed considerably and has remained in the single-digit range for several months. Consumer lending booked at District banks is growing at a healthy rate. Deposit expansion at these institutions has slowed considerably and total borrowings continue to fall below year-earlier levels. At thrifts, deposit growth was 23.3 percent in January, compared with 28.1 percent in the fourth quarter of 1985 and with rates in excess of 30 percent in the two previous quarters.

In District agriculture, the average level of crop prices in January was unchanged from a year earlier, but livestock prices were down 9 percent. Total marketings of fed cattle were also reduced, resulting in a decline in income for producers. Expectations of future declines in grain prices are widespread.

TWELFTH DISTRICT - SAN FRANCISCO

Summary

The Twelfth District economy continues to grow at a moderate pace, but performance across sectors remains uneven. Consumer spending is still growing, although at a slower pace than was seen last fall. In addition to their continuing problems with low prices and foreign competition, some agricultural producers in California sustained damage in the recent floods. The oil price drop, while welcome in most parts of the District, is causing concern in oil producing areas. The aerospace industry remains a source of strength, and robust construction activity has received a further boost from lower interest rates. The financial sector appears to be on the upswing, but for some institutions delinquency rates and questionable asset quality continue to cause concern.

Consumer Spending

In most parts of the District, consumer spending is growing modestly. The growth rate in retail sales volume appears to have slowed in many areas, as no respondents reported that January 1986 sales volume was more than 5 percent above its year-earlier level. Auto sales were generally flat or down in January.

Agriculture

Agricultural producers in most parts of the District remain troubled by low prices and foreign competition. For example, Washington's apple producers are experiencing price declines, induced in part by increased foreign imports of apple juice. Adding to these continuing problems, recent flooding in California caused substantial damage in some parts of the state. Preliminary observations suggest that the floods will probably not be a critical factor in determining farm income or prices this year.

Some individual farmers, however, suffered severe damage. Orchard crops, particularly almonds, appear to have been among the hardest hit, although it will be months before the full extent of the damage is known. Because the trees were in bloom, some blossoms were destroyed either by flooding itself or by the rain and wind, while the weather impeded pollenation of some remaining flowers. In addition, pest control measures were interrupted, so many fear that pest problems will be unusually severe this summer. Some grain crops that had just been planted when the rains hit also appear to have suffered water damage. Vineyards appear to have suffered relatively minor losses, as they were in their dormant state when floods hit. The many field crops that had not yet been planted should also escape serious harm.

Manufacturing and Mining

Aerospace industries in the Twelfth District continue to prosper as strength in both defense spending and demand for commercial aircraft continues. However, companies that built problem components of the Space Shuttle are concerned that the Challenger accident may lead to program cuts and layoffs for their firms.

The dramatic oil price decline seen recently is welcomed in many parts of the District. However, there are already signs in Kern County (California) that drilling activity may slow further from its already low 1985 level. In Alaska, where oil revenues provide 85 percent of the state's income, and the state provides over 35 percent of all jobs, the governor has already taken steps to reduce state spending. Alaskan crude oil was recently selling for $12 per barrel, and it costs about $7.50 per barrel to pump and transport. Consequently, further price drops could be disastrous for the state of Alaska.

Although some early signs suggest that activity in the forest products industries may pick up soon, parts of Oregon that depend heavily on forest products continue to experience little economic growth.

Construction and Real Estate

In many parts of the District, construction activity has strengthened, largely due to the favorable interest rate climate. While some areas are adequately absorbing the supply of office and apartment space, vacancy rates remain close to 20 percent in many areas, including parts of Utah, Washington, and California. The lower oil prices have, however, caused slowdowns in building both in Alaska and in oil producing parts of California.

Financial Sector

Many thrift institutions in the Twelfth District enjoyed a banner year in 1985 as a result of higher interest rate spreads due to lower funds costs. Nevertheless, poor asset quality caused some to founder. Mortgage volume continues to gain in strength, spurred by lower interest rates. Moreover, consumer loans, in the form of credit card, installment, and auto loans continue to show strong volume in most parts of the District. Nevertheless, in some cases delinquency continues to be a problem.

Several respondents believe that poor asset quality will continue to plague some lending institutions. Many argue that the quality of applications is improving, which in the long run should improve asset quality. However, a troublesome number of problem loans remain. Different banks have problems in different sectors of their portfolios, but most problems are in the agriculture, energy, LDC, consumer, and real estate sectors.