

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

January 1988

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SUMMARY*

Most Districts report modest economic growth, with particular strength in New England and weaker conditions in the Dallas and Kansas City Districts. Few District reports cite economic impacts from the stock market decline last October. The Christmas retail season appears to have been satisfactory nationwide, with modest dollar sales gains over last year's levels. In some areas, however, discounting reduced profit margins significantly. Agriculture and forest products industries have seen improved conditions in recent months, with higher prices and strong export demand for many products. Manufacturing orders and production have strengthened considerably in recent months, due in part to expanding exports. Inventories have accumulated for many raw materials and finished products. Construction and financial activity are mixed, both among different types of activity and among regions.

Consumer Spending

Most Districts report 5 to 10 percent gains in the value of Christmas sales over last year's level, with St. Louis and Dallas near the bottom of the range, and Boston and New York close to the top. Boston and Minneapolis report that surveyed retailers held profit margins steady, but reports from New York, Atlanta, St. Louis, and Dallas indicate that heavy discounting in those Districts cut into many stores' profit margins. Retailers in the Philadelphia area report that stores' profit margins on imported products are being squeezed between rapidly increasing costs and consumer resistance to higher prices, so these stores increasingly are turning to domestic suppliers. In contrast, Boston area retailers report that domestic suppliers are unable to meet their needs, so the falling dollar will cause them to switch to suppliers whose currencies have not appreciated with respect to the dollar.

* Prepared at the Federal Reserve Bank of San Francisco and based on information gathered prior to January 15, 1988.

Reports on retail inventories are mixed, with about equal numbers of Banks reporting inventory accumulation and inventory depletion.

December auto sales are reported to be weak in the Kansas City, Dallas, and San Francisco Districts, and auto inventories have accumulated in these areas as a result. In contrast, Cleveland and Atlanta report satisfactory December sales.

Manufacturing

Manufacturing activity is reported to be strong in all Districts, with increased orders and, in many cases, increased backlogs as well. Currently, a large western aerospace firm has more than two years' worth of orders for commercial aircraft on its books.

Cleveland and San Francisco report that exports continue to be largely responsible for their regions' increases in manufacturing activity, and respondents noted changes in relative prices that should lead to further improvements. A Cleveland area business now is able to sell machine tools to various Asian countries for the first time, and respondents in the San Francisco District reported sharp increases in foreign equipment prices during early January.

Reports from most Districts indicate increased inventories of raw materials and manufactured products. Several automobile plants in the Chicago and St. Louis Districts have been closed temporarily to control inventories. However, Richmond reports stable inventories of finished goods, and respondents to the Kansas City survey generally are satisfied with current inventory levels. Airplane inventories at western aerospace companies are very lean, due in part to strong export demand.

Manufacturers in many Districts note increases in input and output prices, with steel prices up dramatically. Several Districts report problems obtaining sufficient supplies of some raw materials, particularly steel products, and some textile and apparel producers in western Tennessee are having difficulty finding sufficient workers for their

rapidly expanding operations. Kansas City reports that, despite shortages of quality steel materials, most materials are readily available and few respondents noted bottlenecks in labor or plant capacity.

Agriculture and Resource Related Industries

The lower exchange value of the dollar continues to stimulate demand for many U.S. products. As a result, exports of several agricultural and forest products are up, depleting inventories in some cases. Prices for soybeans and some other major products have risen. Price increases for poultry in the Texas area are widely expected in the wake of extensive snow damage to poultry operations. The outlook for the energy sector remains weak, with a number of analysts increasingly "bearish" about energy prices.

Construction and Real Estate

Homebuilding and real estate activity were seasonally slack during late 1987 in most of the nation, but have resumed modest activity levels in New England, New York, and Minnesota since the new year began. The winter slowdown, coupled with continued economic uncertainty, has reduced housing sales and construction in the Atlanta District.

Nonresidential construction activity continues mixed, with several Banks reporting continued high vacancy rates and slow building activity. The New York Bank reports that the turmoil in the financial markets apparently has had little or no effect on office leasing outside the New York Metropolitan area, but that activity has slowed in downtown and midtown Manhattan, and on Long Island. Atlanta reports that high absorption and a cutback in development in 1987 caused a significant drop in Orlando's office vacancy rate.

Financial Sector

In New York City, additional cutbacks are taking place in the brokerage and banking sectors as a result of both the stock market crash and basic restructuring.

Applications for consumer loans are weak overall, with significant declines in the rates of growth reported in the New York, Philadelphia, Atlanta, St. Louis, and Seattle areas. Some banks attribute the current weakness in part to declines in applications for car loans, and none attribute it to the stock market crash.

Demand for mortgages is weaker than it was last year in most parts of the country, partly due to vigorous refinancing activity last year. Several western bankers report that demand for home equity loans was strong throughout 1987, and Atlanta reports that homeowners drew down home equity lines to finance Christmas purchases. In the suburbs surrounding New York City, demand for home equity loans generally is weak.

FIRST DISTRICT - BOSTON

First District merchants and manufacturers ended the year with satisfactory growth in sales and earnings. In the aftermath of the stock market decline, retailers achieved relatively robust sales increases without shaving margins. Most manufacturers also felt little or no impact from the stock market decline. The few who sensed some weakening in demand late in the year report a recent rise in orders. Both groups view 1988 with cautious optimism and are proceeding with spending plans unchanged. Although the residential real estate market has been unseasonably weak, many realtors also note a recent pick-up in sales activity.

Retail

Despite fears that the stock market decline would seriously cut consumption expenditures, a sample of First District retailers report Christmas sales up a satisfactory 8 to 10 percent above year-ago levels. Some major chains stepped up promotions, but most retailers did not. Thus margins generally held steady, and price increases paralleled the 1 to 3 percent rise in the cost of goods sold.

Most respondents are optimistic about the new year, and all intend to build up their inventories and expand their operations. One major discount chain is, however, reassessing its building program in light of the stock market decline.

The respondents do not anticipate that the fall in the dollar will cause them to increase orders from domestic sources significantly. Where

import costs have risen substantially, firms expect to switch to foreign suppliers whose currencies have appreciated relatively little. Some retailers also report that they can no longer find domestic manufacturers capable of supplying their needs.

The District's tight labor market remains a major concern. The situation is causing rising wages and understaffed operations.

Manufacturing

Most First District manufacturers enjoyed a good fourth quarter with real gains in sales and orders of 3 to 12 percent from year-ago levels. Increases in earnings ranged from 15 to 45 percent. Makers of producer goods and consumer essentials report no impact from the stock market decline. Those serving the auto industry or producing discretionary consumer goods saw some weakening in November or December but almost universally report a recent pick-up in orders. Respondents were divided on the importance of exports. Half serve foreign markets from foreign affiliates; thus, exports played little role in their sales gains. The other half cited significant increases in exports or export orders.

Contacts continue to stress efforts "to run lean." Inventories are being monitored carefully and are generally termed "satisfactory." Employment levels are stable or increasing slightly. Several firms mentioned that 1987 productivity gains of 5 to 6 percent allowed them to meet increased demand with only modest growth in employment.

Capital spending will generally continue at or above the 1987 pace. Several firms plan increases of 10 to 25 percent, while only one anticipates a significant decline. These plans reflect the introduction of

new products, maintenance needs and continued efforts to increase productivity. Little expansion of capacity is likely. In no case has the stock market caused any change in respondents' plans.

Increases in the cost of materials are widespread - with steel, copper, precious metals, glass, pulp and paper, plastic resins, DRAMs from Japan and various imports from Europe all cited. Contacts expect materials prices to rise considerably faster in 1988 than in the last 18 months. In particular, spot steel prices are reported to be up 10 to 15 percent, and availability is a potential problem. In contrast to the situation a year ago, contacts are now able to pass some of these increases on to their customers. Most expect their own prices to rise an average 3 to 4 percent.

First District manufacturers view 1988 with cautious optimism. No respondent foresees a recession this year, although one-third expect sales growth to be slightly less than in 1987 or than they forecast in early October. Another third, however, expect a very good year with sales increases of 15 to 25 percent. Many are keeping a wary eye on consumer spending, and a few expressed concern about self-fulfilling prophecies.

Residential Real Estate

Throughout most of the First District, the residential real estate market is making a moderate comeback after an unusually slow pre-holiday and holiday season. Although sales have generally increased since the turn of the new year, they are weaker than they were last year at this time. In most of the region, reports suggest little variance in sales activity among small homes, large homes, and condominiums. Many realtors expect the recent increase in activity to continue through the spring.

SECOND DISTRICT--NEW YORK

Developments in the Second District economy varied among sectors during recent weeks. Consumer spending was stronger than many retailers had anticipated and the turmoil in the financial markets had little effect on office leasing outside the New York metropolitan area. Business activity was somewhat mixed, however, and residential construction was seasonally slack. Small and medium-sized banks reported no appreciable decline in the demand for consumer loans since the stock market crash.

Consumer Spending

District retailers reported that, on the whole, consumer spending in recent weeks was more spirited than many had anticipated, given the stock market crash and its retrenching effects. While sales in the District were somewhat weak during the first half of November, they strengthened as the month progressed, and during December were either on or slightly below plan. Because of exceptionally heavy discounting during the Christmas season, however, several retailers stated that they anticipate a substantial drain on profit margins.

Respondents reported over-the-year sales changes ranging from -2.5 percent to +8 percent in November and from +6 percent to +12 percent in December. An annual survey by the Retail Council of New York State, which primarily covers stores outside New York City, found an average increase of 5-6 percent during the Thanksgiving Friday to Christmas Sunday period.

Items in good demand were certain types of women's apparel, perfumes, jewelry, and other accessories while sportswear and electronics sold poorly. An

unusually large number of foreign buyers was noted at several New York stores, attributed to the relative strength of most foreign currencies.

Business Activity

Economic conditions in the Second District have been somewhat mixed since the last report. While purchasing agents in the Rochester area noted only a seasonal slowdown in manufacturing activity, responses from firms in Buffalo indicate that some slackening of business activity may have occurred there. In New York City additional cutbacks are taking place in the brokerage and banking sectors as a result of the stock market crash as well as some basic restructuring.

Despite the recent and continuing layoffs in New York City, District unemployment rates remain lower than the national average. New Jersey posted a rate of 3.9 percent in December while New York's was a slightly higher 4.5 percent. New York City's rate of 5.0 percent also was relatively low. With more layoffs scheduled in the City during the weeks ahead, many observers anticipate a negative impact on District unemployment rates in the near future. Since announcements of new and expanding industries have been made in other areas, however, the net effect on District employment remains to be seen.

Construction and Real Estate

Homebuilding activity has been seasonally slack in much of the District, but ground was broken in December for an 1107-unit multifamily development on Roosevelt Island, a part of New York City. This is the first residential construction on that island in more than ten years and, in contrast to the luxury condominiums which characterize most new apartment buildings in the City, will be primarily middle-income rental housing. Another large development which is slated to start in February is the construction of 1000 units of townhouses and condominium apartments as part of a \$225 million mixed-use project in central New Jersey. In another attempt to deal with the shortage of affordable housing, more

than 24 employers on Long Island recently formed a partnership to foster additional middle-income housing citing the increasing difficulty in attracting and keeping employees there due to the high price of homes.

The turmoil in the financial markets has apparently had little or no effect on office leasing outside the New York metropolitan area. However, activity has slowed in downtown and midtown Manhattan and on Long Island, and many observers expect vacancy rates to rise in the wake of continuing employment cutbacks at brokerage and banking firms. Citing this softening real estate market, five commodity exchanges recently abandoned plans to build a 65-story skyscraper in downtown Manhattan, and considerable uncertainty surrounds the proposal for a large midtown project which originally was to have housed a major brokerage firm.

Financial Developments

Senior officers of small and medium-sized banks in the Second District reported that they have not noticed an appreciable decline in the demand for consumer loans since the stock market crash. Most did state that demand is not as strong as it was a year ago, but several linked this to the Tax Reform Act provision reducing interest expense deductions rather than to the crash. Many officers noted delinquencies on their consumer loans have risen recently, though not to alarming levels. Those surveyed expressed uncertainty as to whether the rise should be attributed to the crash or to the normal seasonal increase in delinquencies following the holiday season. In spite of the rising delinquency rates, only one bank in the survey has tightened credit standards for loan applicants in recent months. Consumer demand for mortgages and home equity loans is generally weak, especially in the suburbs surrounding New York City. Though the residential real estate market is typically slow during the winter months, some bankers thought that the crash may have made some individuals more reluctant to purchase homes. In contrast, demand for bank credit cards remains steady.

THIRD DISTRICT - PHILADELPHIA

There are mixed signals in the Third District economy as 1988 begins. Manufacturing activity was flat in January, although factory employment continued on an upward trend. Retail sales for the holiday season increased year-over-year, except for women's apparel and consumer electronics, and met or exceeded merchants' expectations. The growth of aggregate bank lending was slowing, with consumer loan volume at a standstill and business lending up just slightly; however, real estate lending continues to move up strongly.

Most business contacts expect little growth in 1988. Manufacturers forecast only steady business for the first half, and they do not expect to continue adding to payrolls. Retailers said sales in January were good, but they expect consumers to step up their buying only slightly, if at all, as the year progresses. Bankers, citing the improvement in the manufacturing sector in 1987, are optimistic that commercial lending will regain momentum this year, but they do not expect strong demand for consumer credit.

MANUFACTURING

The region's manufacturing sector marked time in the first month of the year, after expanding through most of 1987. Two-thirds of the industrial firms participating in the January Business Outlook Survey reported steady business, and the number of companies starting the new year at a slower pace nearly equaled the number stepping up production. Durable goods makers reported some improvement, while nondurable goods producers said business was steady.

Specific measures of industrial activity in January showed little change from December. Order backlogs leveled off and inventories moved higher, indicating an easing from last year's operating pace. However, fractional increases in new orders and shipments were reported. Employment also posted a slight gain for the ninth consecutive month; although 75 percent of the companies surveyed in January were maintaining steady payrolls, 19 percent added workers while only 6 percent made cuts.

Despite the apparent interruption of growth in January, survey respondents reported continuing upward movement in prices--60 percent said input costs were higher than in December, and nearly 40 percent raised prices for their own products. Looking to the first half of 1988, 72 percent of the respondents predict further increases in the prices of goods they purchase and 41 percent plan to charge more for the goods they make.

January's pause in manufacturing growth appears to be coloring survey participants' views of the future. Neither production nor employment is expected to change from current levels in the first half of 1988. These expectations, combined with an anticipated modest increase in shipments, should work to reverse this month's inventory buildup.

RETAIL

Most Third District retailers queried in January said sales for the Christmas season met expectations, and some department stores and general merchandise stores reported that sales were above plan. Overall, area merchants said sales were about 5-7 percent above 1986 results, in dollar terms. Discount stores and department stores catering to relatively affluent clienteles turned in better performances than stores selling middle price range merchandise.

While promotional discounting in the days just before Christmas was greater than planned for many stores, most retailers said margins were not seriously

reduced. This was not the case for specialty shops, however. Despite large markdowns, stores selling women's apparel and consumer electronics did not have a good season. Some reported sales declines of up to 10 percent from 1986.

Merchants contacted in mid-January said sales were running at a healthy pace, but they are worried about the year as a whole. Most have adjusted their purchasing plans for a year of slow or no growth in sales, in real terms, and many specialty stores have cut back plans for renovations and expansion.

Store executives said cost containment will command attention this year. Labor costs are rising as stores face shortages of salespeople and other workers. Also, retailers reported that costs of imported goods are rising more rapidly now than in the past few years, and consumers are resisting stores' attempts to pass cost increases through to selling prices; consequently, profit margins on imported goods are falling and stores are turning to domestic suppliers.

FINANCE

Loan growth at major Third District banks was slowing as 1987 came to a close, continuing a trend that began at the start of last year. Among the major credit categories, real estate lending is strongest and consumer lending is weakest. Total personal loan volume outstanding near year-end 1987 was only 3 percent higher than in December 1986, and bankers surveyed in mid-January said consumer lending has been flat or down in recent weeks. Most bankers expect little growth in this type of lending in 1988.

Although growth in commercial and industrial lending eased during 1987, bank credit officers contacted recently believe lending to businesses will accelerate, and some have already noticed an increased demand for commercial credit. Bankers believe economic conditions in the region will remain good for

most of 1988, spurring financing needs of local businesses, particularly manufacturers.

Total deposits at large Third District banks in December were at the same level as in December 1986. Demand deposit balances have declined since October, ending the year lower than where they started. Growth in nontransactions deposits, while slow, has accelerated in recent months. Some bank asset/liability managers indicated in January that they were boosting interest rates on certificates of deposit in anticipation of tighter money market conditions in the second half of 1988.

FOURTH DISTRICT -- CLEVELAND

Summary

The year 1987 closed on several optimistic notes. Manufacturing, boosted by increased export activity, continued its recent rebound with output, new orders, and employment up over the previous month. Holiday retail sales were slightly better than expected, aided by an increase in auto sales. Many local area unemployment rates remained at or below the national rate. District loan demand continued to increase at a modest rate.

Retail Sales

An increase in auto sales in December helped boost Holiday retail sales in the Fourth District above last year's sales levels. Most car dealers reported increased sales in December over the previous two months, as incentive programs once again attracted consumers.

Sales volume differed widely across cities and across product lines. For instance, one major retailer reported that sales were up 12.5 percent in their Pittsburgh stores but up only 5 percent in their Cleveland stores. Sales of apparel were up, due partly to the deep discounting before Christmas. On the other hand, sales of durable home goods were down, reflecting consumer caution after October's stock market decline. Discount retailers reported a greater increase in sales than top-of-the-line outlets. The consensus among retailers was that sales will slow down during the first half of 1988. Prices are expected to show only a modest increase as price pressure from imports eases.

Manufacturing

The manufacturing sector continued to show positive signs. Output, as measured by the Ohio Manufacturing Index, increased by 0.2 percent in November, rebounding

slightly from the previous month's decline. Gains in durable goods, especially primary metals, transportation equipment, fabricated metals, and instruments, were primarily responsible for the November turnaround. Manufacturing in nondurable goods fell 0.1 percent in November, due to continued decline in printing and publishing and food processing.

Reports from purchasing managers concurred with the uptick in the output index. In the Cleveland area, all indicators were higher in November than in previous months. Respondents to the purchasing managers survey indicated higher employment, higher raw material, supply, and finished product inventories, and an increase in new orders. Two-thirds of the respondents reported higher prices. Specialty steel items and plastics products were reported to be in short supply. Purchasing managers in the Cincinnati area reported these indicators to be "at strong levels," but down slightly from the three-year highs of the past few months.

Steel production in the Youngstown and Pittsburgh areas remained strong. Youngstown producers shipped 6 percent more steel in December than they did in December of 1986. Pittsburgh producers shipped 13 percent more than a year ago.

Exports continued to be largely responsible for the increase in manufacturing activity. Machinery, chemicals, and instruments contributed significantly to the increase in export activity. One local business person remarked that for the first time he is now able to sell machine tools to various Asian countries.

Labor Markets

Ohio's total employment increased by 14,000 workers, led in part by a 4,000 worker advance in manufacturing. However, despite the recent increase in manufacturing employment, Ohio lost 7,500 factory jobs between November 1987 and November 1986. The largest losses over the year occurred in fabricated metals, machinery, autos, and aircraft and parts. Primary metals posted the largest gain of the

major manufacturing sectors, adding 5,400 workers. Continued strength in the service sector boosted the year-to-year increase in total employment for Ohio to 111,500, a 2.4 percent increase. November's unemployment rate stood at 5.9 percent, up slightly from previous months but still equal to the national rate.

Area businesses anticipated moderate hiring in the first quarter of 1988. In Akron, 43 percent of local employers surveyed by a nationwide employment agency planned to increase staff, while only 3 percent expected cutbacks. Pittsburgh area businesses were less optimistic. Only 17 percent of those surveyed planned to increase staff during the next three months. Twenty percent said that they anticipated cutbacks. The Cleveland area hiring outlook appeared mixed. Twenty-five percent of local businesses expected to increase their workforce, while the same percentage expected to cut back. Overall, job opportunities looked best in services and durable manufacturing.

Banking

District loan demand continued to be modest. Total loans outstanding at large banks grew at an annual rate of 5 percent during November and December. Most of the loan growth was in business and consumer installment lending. Commercial and industrial loans rose at an annual rate of 5 percent over the last two months, up slightly from October's pace. Consumer installment lending increased at a double digit rate in November and December, but much of the growth may have been attributed to seasonal factors. Mortgage rates generally rose in October and November, contributing to a slight fall in outstanding real estate loans in November and December.

FIFTH DISTRICT -- RICHMOND

Overview

The District economy has apparently expanded further in recent weeks. Most of our directors and advisory council members reported that their local economies were robust at year-end, and our regular surveys showed a continuation of rising employment in retailing and manufacturing. Retail sales for the most part held up well through Christmas and retailers look for good winter and spring sales. Manufacturers reported generally strong activity and higher input prices, but they were somewhat less optimistic than they were a few weeks ago about their growth prospects. In other selected District sectors, financial institutions said they expect a pickup in some categories of loan activity, and most seaports reported increases in volume.

Consumer Spending

Most District retailers responding to our regular survey reported that Christmas sales were above year-ago levels. However, 38 percent of the respondents reported lower sales of big ticket items, while 43 percent reported no change. Additionally, nearly half of the retailers said that post-Christmas inventory levels were higher than last year's.

District retailers expect their sales to increase in the next six months. Sixty-five percent of those surveyed believe their sales will rise over the period, although about one-third expect weakness in big ticket items.

Manufacturing

Manufacturing activity in the District has apparently continued to increase in recent weeks. Thirty-five percent of the respondents to our regular mail survey reported increases in shipments -- the same percentage as in the previous survey. The

survey results indicated that orders, inventories of materials, and employment rose, while unfilled orders and inventories of finished goods remained unchanged, and the workweek declined slightly.

The percentage of manufacturers who expect shipments and orders to increase over the next six months were unchanged from the previous survey. In our two latest surveys, both conducted since the stock market crash, about 40 percent of the producers indicated that they believed their shipments and new orders would grow during the first half of the year, as compared to about 50 percent who anticipated growth before the crash. Most manufacturers plan to reduce their inventories of materials in the next six months, but most also expect their inventories of finished goods to rise.

The prices of both raw materials and finished products evidently rose further in recent weeks according to District manufacturers. Fifty-seven percent of the respondents reported higher raw materials prices and 32 percent reported higher prices for their finished products. Additionally, one-third of the respondents said they had been unable to obtain adequate supplies of some raw materials, particularly metals.

Reports from District manufacturers were somewhat less optimistic about the outlook for the general economy than about their own business prospects for the first half of 1988. Half of the respondents anticipated no change in the level of general business activity in the nation, while the remainder were equally divided between those expecting growth and those expecting contraction.

Mining

District coal production during the last weeks in December was slightly ahead of production in the same period a year ago. However, utilities have reportedly not been stockpiling much coal. The United Mine Workers' contract expires on January 31, but coal industry sources said that apparently utilities believe they can obtain sufficient

coal supplies from non-union companies if a strike occurs. District coal production for 1988 is expected to remain at 1987 levels.

Financial

Fifth District financial institutions responding to our recent survey reported little change in business conditions from a month ago, and they remained optimistic about the months ahead. Seventy-two percent expect the nation's rate of economic growth to increase in the coming six months, and 64 percent look for increased economic growth in their local areas over the same period.

Although executives of financial institutions reported little change in loan activity in recent weeks, they anticipate increases in the demand for home mortgage loans and for commercial and industrial loans in the months ahead. Rural bankers reported that their banks were doing well and had bright prospects for the future. These bankers also indicated declines in the number of financially troubled farmers and farm foreclosures.

Ports

Representatives of the Port of Hampton Roads and the Port of Charleston, South Carolina -- two of the three major District ports -- noted general increases in both loadings and unloadings for the month of December. The Port of Baltimore, however, reported declines in imports and unchanged exports in recent weeks. All ports are expecting increased volumes in 1988.

SIXTH DISTRICT - ATLANTA

Unfolding national economic trends also are evident in a reading of business conditions in southeastern states. Manufacturing activity is strong in many foreign trade related activities such as agriculture, paper and chemicals. Producers in housing and consumer goods industries are becoming concerned about soft demand. Holiday spending, while not great, turned out to be better than retailers expected in the immediate aftermath of the stock market crash. Although construction activity continues to slow, the regional economy is comparatively healthy on balance.

Employment and Industry. Manufacturing activity remains brisk for most industries. There is no evidence of significant cutbacks in capital spending or orders for major regional industries, but consumer goods producers are edgy. Textile producers continue to operate at high utilization levels, with carpet producers reporting tight labor conditions. Increases in prices of imported and domestic clothing plus softening demand is resulting in an unwanted apparel inventory buildup at the manufacturing level, possibly signaling a production slowdown this year.

The chemical and paper industries are benefitting from higher prices, improved domestic and foreign sales, and lessened import competition. Strong textile markets also have helped segments of the chemical industry, and the cheaper dollar has encouraged foreign paper mills to buy U.S. wood pulp. New paper mills and plant expansions have recently been announced.

Defense related government contracts continue to benefit the region; in Huntsville, the new space station contract will eventually add 2000 new jobs to payrolls. In metals, more than 500 steelworkers in Alabama are expected to return to work earlier than originally planned and an aluminum smelting plant is returning to full production in Tennessee. On the other hand, home appliance manufacturers are concerned about scaled-back consumer spending, lower housing start levels and rising raw material prices.

Consumer Spending. Major department stores made slight-to-moderate real gains in holiday sales over the previous Christmas but sales at specialty stores such as women's fashion shops were disappointing. Retailers boosted sales volume by promoting heavily and reducing gross profit margins in the process. Efforts to clear excess merchandise in January have been hampered by poor weather. Orders and inventories for spring sales are conservative and expected to be about the same as last year's levels. Many retailers expect to see more discounting this spring than last year and a more highly promotional environment, particularly in products experiencing the sharpest slowdown in spending such as women's sportswear and electronic items.

Auto dealers feel that December's sales compared rather well with year-end 1986 considering strong tax incentives at that time. Light trucks continue to be the star performer offsetting some weakness in domestic car models. The geographic pattern of vehicle sales in 1987 mirrored the overall consumer spending pattern in the District--activity in the eastern part was stronger than that nationally, while the western part lagged behind the nation's performance.

Construction. The winter slowdown, coupled with continued economic uncertainty, has reduced housing sales and construction. Markets in Louisiana and Mississippi are hampered by distressed local economies and outmigration as well. Activity is mixed in Tennessee--Nashville has become overbuilt in both single-family and multifamily homes while Knoxville's housing market seems to be building momentum. The huge Florida and Georgia markets, which were fairly stable in 1987, are expected to soften in 1988.

Analysts expect the widespread commercial construction and leasing slowdown to continue this year. The office market, in particular, remains overbuilt in most of the large markets. A notable exception is Orlando, where high absorption and a cutback in development in 1987 caused its office vacancy rate to drop significantly. According to recent reports, foreign investors' interest and participation in Atlanta's commercial real

estate market is growing. The Japanese have been the most active, but European investors' activity is also growing.

Financial Services. Consumer and real estate loan growth fell in December, with consumer borrowing actually declining in Alabama and Louisiana. The slower expansion of consumer credit in the other states reflects a smaller increase in borrowing for car purchases. Homeowners also are reported to have drawn down home-equity lines to finance Christmas purchases. Other residential mortgage financing is sluggish due to seasonal factors and low volumes of refinancing relative to late in 1986. Regional banks are requiring commercial developers to pre-lease more space to qualify for loans.

Tourism. The U.S. cruise industry is growing at a fast clip. Ports such as Miami--currently the world's most used cruise liner port--Fort Lauderdale, Tampa, and New Orleans should benefit from this increased traffic, which peaks during the winter. The airline industry has yet to note any negative impacts attributable to the stock market's crash, and the dollar's most recent decline has not spurred any noticeable trends in air travel. Airline officials anticipate an eventual increase in tourists to the southeast as a consequence of the dollar's decline. The air fare war now going on in Atlanta and Florida was designed to fill more seats during the slack winter quarter. In Georgia, Florida, and Louisiana, business travel to attend conventions and meetings during January is running ahead of last year's performance.

Mining, Agriculture and Forestry. The kaolin industry is prospering as export activity increases and demand from paper companies remains strong. Industry expansion projects, prompted by favorable short- and long-term prospects, are underway in Georgia. The phosphate industry continues its recovery after several years of poor performance, aided chiefly by a fast-growing export market.

Southeastern crop farmers are enjoying higher prices. Florida's citrus industry is especially benefitting from a larger crop and stable to higher prices. Forest industries are continuing to prosper, with a bright outlook for 1988.

SEVENTH DISTRICT -- CHICAGO

Summary

Business activity in the District is expanding, overall, with many manufacturers reporting strength tied to rising exports, improved competitiveness with imports, and rising capital spending. Continued slow car sales are partly offset by the expanding truck market. Purchasing managers' reports for District metro areas continue robust, though our contact with the Milwaukee group was concerned about prospects for early 1988. Employment continued to trend upward in District states through November, but the effects of widening layoffs, particularly in autos, cut Michigan employment in December and probably in January. Demand for steel has shown no letup from the strong pace of much of last year. Construction activity appears to be holding up in the District. Several lines of consumer goods are reported selling well, helped by cold weather and promotions. Recent USDA reports have firmed 1988 price prospects for most District farm commodities.

Purchasing Managers

December purchasing managers' surveys in the Chicago, Indianapolis, and Milwaukee areas show continued expansion. The Chicago survey indicates strong growth in production, orders, and backlogs as well as delays in filling orders and further price increases. Activity in the Indianapolis area is described as still moving along briskly, with continued strength in the area's industrial sector. Orders and backlogs continued to rise in the Milwaukee area, though increases were not as widespread as earlier. The slower rise is thought to be mostly seasonal, but our contact was concerned that orders placed in response to lengthening lead times and rising prices could quickly evaporate if the late 1987 slowdown in additions to bookings proves to be more than seasonal.

Employment

District states' payroll employment continued to expand through November, but the year-to-date rise trailed that in the U.S., with slower gains concentrated in Michigan and Illinois. Manufacturing employment in Michigan was below a year earlier, reflecting layoffs at auto assembly and parts plants, and cuts in related industries. With nonmanufacturing payroll employment in Michigan showing relatively large gains, however, total nonfarm payrolls in November were about 1% above a year earlier. The household survey also shows total Michigan employment above a year earlier in November, but December was lower. Sources in Michigan indicate that the weaker employment situation in December principally reflects announced layoffs. Some of those who reported themselves as laid off in the December household survey are thought to have taken accrued vacation time initially, and consequently to have been counted as employed in the December payroll figures. Other companies in the District which have recently announced employment cuts include financial service firms in Chicago, and an appliance manufacturing plant in Michigan which closed and shifted production to plants outside the District. Corporate staffs in Chicago were cut by a large railroad, a maker of building materials, and a diversified producer of consumer products. GM's Electromotive Division plans to cut employment by 2,000, to 2,300, at its Chicago-area plant, one of only two U.S. plants that build new locomotives, and shift locomotive production to Canada.

Motor Vehicles

Auto production plans have been trimmed, bringing first quarter schedules more in line with analysts' expectations based on fourth quarter sales trends. Announced cuts in assembly schedules are feeding back to parts plants. In addition to temporary closings to control inventories, five Michigan auto assembly and parts plants were closed

permanently in December. In contrast, total truck output in the first quarter is projected at a record level, for any quarter, in line with the strength in sales.

Steel

Demand for steel bounced back strongly following normal year-end customer shutdowns. Lead times are strengthening, with the first quarter booked and delivery times for orders currently placed extending into the second quarter. Demand from appliance makers is holding up. Structural steel fabricators generally are quite active, though the level of activity varies considerably among geographic areas. Sales people foresee no letup in incoming contracts. The Chicago market is described as active with numerous small and medium-size orders. Projects being put out for bid indicate strength in spending on shopping centers and power plants. Warehouse business, generally for smaller projects, was highest ever last year and remained extremely strong through year-end. Upward price pressures continue.

Other Manufacturing

Reports from other manufacturers are generally quite positive. Shipments of corrugated containers in North Central states were very strong in November, and one company's results suggest that the industry uptrend continued in December. Seasonal closings in late 1987 at box plants' customers were described as normal, with no extended shutdowns reported. A linerboard price increase announced for February 1 is expected to go through without resistance. Makers of capital goods and equipment for installation in new construction projects are seeing strong business. Other lines noted by our sources as showing good gains include medical supplies, printing and publishing supplies, abrasives used in industry and construction, and materials for highway signs.

Construction and Real Estate

Construction activity continues at a high level in District states, apart from the normal seasonal slowing. (Comparisons of early 1988 with year ago will appear weak

because of last winter's unusually mild weather.) Nonresidential construction contracts in District states, in square feet, were 14% above a year earlier in the first 11 months of 1987, and residential contracts were 4% higher, both stronger performances than the U.S. Demand for building materials, including cement and gypsum board, showed stronger gains in the District than the nation. New high-rise buildings continue to be announced for downtown Chicago. Paving activity will be strong in the Chicago area in 1988. Home prices in the metro area are estimated to be about 10% above a year earlier.

Consumer Spending

December sales were "satisfactory," in the view of a major general merchandise retailer. Sales in early 1988 started strong, helped by cold weather as well as promotional activity. Lines showing good gains include home improvement, household appliances, personal care, hardware (especially cordless tools), furniture, and children's apparel. Retail inventories are regarded as in good shape.

EIGHTH DISTRICT - ST. LOUIS

Summary

The District's economy continues to expand at a moderate pace. Employment growth, one of the broadest indicators, has been particularly strong in the District. Holiday sales growth, while less than in recent years, was stronger than many analysts and retailers had anticipated in light of the stock market crash. Construction activity was mixed with expanding residential construction and declining nonresidential building. Bank lending slowed in the fourth quarter due to weakness in consumer borrowing.

Consumer Spending

District retailers report that holiday sales were 2 percent to 6 percent above year-ago levels, representing little or no gain after inflation. Sales were stronger in Louisville, where several contacts reported double-digit gains. Retailers initially feared that the stock market crash would lead to sharp declines in consumer buying. Apparel sales, particularly women's wear, were soft. Nonetheless, retailers indicated that, while consumers were cautious, they did spend.

Respondents reported that numerous holiday promotions were used this year to counter the possibility of sharp spending declines. In addition, many indicated that sales had slowed before the October 19 market crash, prompting retailers to stock their stores conservatively. As a result, most contacts had inventories at or below desired levels. Sales since Christmas have been slow, due, in part, to harsh weather in

some areas. Retailers expect first quarter sales to be only slightly above levels of a year earlier. One respondent concluded that holiday sales promotions have borrowed from first quarter sales.

Employment

District unemployment rates tended to decline throughout 1987. An exception is Missouri, where the jobless rate increased slightly. District nonfarm employment growth outpaced the nation in the three months ending November, expanding at a 4.1 percent annual rate compared with 3.2 percent nationally. Regional growth was concentrated in the services, construction and manufacturing sectors. District manufacturing employment grew at a 4.5 percent rate in the September-November period with strong gains in the fabricated metals and textile/apparel industries. Some textile and apparel producers in Western Tennessee are having difficulty finding workers for their rapidly expanding operations. The transportation equipment sector was the only major manufacturing industry to suffer employment declines. District auto makers, concentrated in Missouri, continue to lay off assembly workers to trim excessive inventories; further lay-offs and plant closings are planned for the first quarter.

Construction

In recent months, residential construction has grown more rapidly in the District than in the nation. The value of contracts for residential building expanded 3.2 percent in the three months ending November, while dropping 3.2 percent nationally. Single-family homes continue to account for most of the growth. The value of nonresidential

contracts declined by 11.8 percent in the three months through November, primarily due to a sharp drop in Missouri.

Banking

Total loans at weekly-reporting District banks grew at an 8.7 percent rate in the fourth quarter compared to 13.4 percent for the same period in 1986. Commercial and real estate lending grew at rates similar to those recorded last year. Consumer loans, however, slowed considerably, declining at a 3.7 percent rate compared to a 25.4 percent increase for the fourth quarter of 1986.

Fourth-quarter deposits at these banks grew at an 11.1 percent rate versus 18 percent for the same 1986 period. Large time deposits increased at a 36.5 percent annual rate over third-quarter levels compared to a 0.6 percent rate of decline for the same period last year. Time deposits totaled \$4.9 billion or 21 percent of total deposits at the twelve weekly-reporting District banks. Last year, total time deposits were only 17 percent of all deposits. The surge in large time deposit growth may be related to investors getting out of the stock market after the October crash. Demand deposit growth in the fourth quarter slowed to a rate of 11.3 percent compared to 41 percent for the same period last year. NOW account growth also slowed during the quarter while MMDAs declined at a 15.3 percent rate.

NINTH DISTRICT - MINNEAPOLIS

The year 1987 ended positively for most of the Ninth District's economy. Labor market conditions continued to be favorable. Consumer spending was generally healthy, not crippled by the stock market decline as some had feared. Among resource-related industries, mining and wood products firms were quite active. Agricultural conditions remained stable. Only nonresidential construction appeared to weaken in recent months.

Labor Markets

Labor market conditions in the district continued to be reasonably favorable. Minnesota's market continued its recent trend of concurrent increases in employment levels and unemployment rates. Analysts attribute the unemployment rise to statistical aberrations; they note that the number of unemployment insurance claimants in the state has stayed below year-earlier levels. Furthermore, the Minneapolis index of help-wanted advertising was 13 percent higher this November than last. In the Dakotas and Montana, only normal seasonal employment declines occurred during November, leaving unemployment rates there below year-earlier levels.

Consumer Spending

Retail merchandisers were generally pleased with the results of holiday sales. One large chain reports a healthy increase in Midwest sales this December, compared to December 1986. Another big chain reports that its holiday sales were better than it had forecasted in October. A smaller group of stores concentrated in smaller cities experienced double-digit sales growth this December compared to last, even when excluding new stores. This group also notes that its profit margins were better than last year. And from

eastern North Dakota, a Bank director and a newspaper editor report good holiday retail sales there.

District managers of two domestic-vehicle manufacturers ended the year on an optimistic note, expecting 1988 to be as good a year as 1987. Both managers mention that truck inventories were low for this time of year, while car inventories were not.

Housing activity has been fairly normal in recent months. For the usually slow month of December, home sales in Minneapolis and St. Paul were a bit lower than a year ago. But some signs of a pickup appeared elsewhere in Minnesota. Residential building contracts in the state rose significantly this November, and the head of a builders' association says that most builders look to 1988 as being "a pretty good year."

Resource-Related Industries

In general, favorable news continues to be reported about the district's major mining and resource-processing sectors. Lower production costs and the lower exchange value of the dollar are continuing to improve the outlook for iron-ore mining. Indicative of this improvement is the significant increase in shipments of iron ore and pellets through the Duluth-Superior Port during 1987. Some industry analysts predict that, in 1988, total shipments from Minnesota could increase to their highest levels since the boom year of 1981. A Bank director notes that in Montana, coal production increased during November, although oil-drilling activity slacked off. Elsewhere in the state, additional gold mines are likely to open. A Helena branch director says that the timber industry in Flathead County, Montana, was doing the best it has in five years. Wood products mills are busy in Montana and in Michigan's Upper Peninsula. According to a Bank director, the Upper Peninsula has also benefited from unusually high copper prices.

Agriculture

Agricultural conditions remained stable in the district. The Minnesota index of prices received by farmers held steady between November and December 1987. Cattle prices remained high while hog prices, which had been plummeting, leveled off. The lower exchange value of the dollar and bad production conditions overseas are aiding demand for U. S. crops, helping boost prices for major district crops, such as soybeans. This Bank's most recent survey of district farm lenders indicates that they believe farm income continued to improve in the fourth quarter. The lenders say fewer of their farm borrowers are loaned up to their credit limits than in previous quarters.

Nonresidential Construction

Although 1987 was largely a good year for nonresidential construction, preliminary signs are not as favorable for 1988. In Minnesota, nonresidential contracts fell during November, to 18 percent below the November 1986 level. A director of this Bank's Helena branch notes that commercial construction in the Billings, Montana, area remained strong late in 1987. But in the Minneapolis-St. Paul metro area, the near-completion of much unleased office and retail space is dampening the outlook for further commercial starts in the district's largest market.

TENTH DISTRICT - KANSAS CITY

Overview. Little improvement is apparent in the Tenth District economy, in spite of relatively high farm income in 1987. Christmas retail sales were generally higher than a year earlier but lower than expected, and new car sales are slow. Manufacturers' input prices continue to rise moderately. If recent world oil market conditions continue, some of the 1987 improvement in the district energy industry may be eroded. Home mortgage demand and residential construction activity both remain weak. Loan demand and deposits at commercial banks are both up slightly. Agricultural banks report an improvement in yearend loan repayment rates.

Retail Sales. Tenth District retailers report sales equal to or above year-ago levels, and unchanged or slightly improved over the past three months. Christmas sales were generally higher than a year ago but lower than expected. Sales of apparel, cosmetics, and other soft goods are strong while durable sales are weak. Nearly all respondents plan to trim inventories or hold them at present levels. Expectations for future sales are cautiously optimistic and only small price increases are anticipated in the next few months.

Automobile Sales. Automobile dealers generally report that sales were slow in December. Although dealers desire leaner inventories, slow sales are keeping inventories steady. Adequate financing is available for both dealer inventories and customer purchases. Overall, dealers are hopeful that 1988 sales will be near 1987 levels.

Purchasing Agents. Purchasing agents report that their input prices are moderately higher than a year ago. The steepest price increases in the last several months have been for steel-related inputs and further increases are expected for these inputs in the near term. Most materials are readily

available, although quality steel materials are reported to be in short supply. Respondents are generally satisfied with current inventory levels and most report no unusual bottlenecks in labor or plant capacity.

Energy. The inability of OPEC to agree on production quotas in December 1987 has caused world oil prices to weaken and become more volatile. If these market conditions continue, some of the stability established in the district's energy industry during 1987 could begin to erode. The average weekly number of operating drilling rigs in the Tenth District increased only slightly from 360 in November to 363 in December, about 23 percent above the average weekly level a year earlier but less than one-fourth its 1982 peak.

Housing Activity and Finance. Area homebuilders report that housing starts are below both last year's and last month's levels. Multi-family construction is expected to weaken further but single-family construction is expected to stabilize. Most homebuilders report steady sales of new homes. Respondents express no immediate or future problems regarding materials prices, availability, or delivery times.

District savings institutions generally report that savings deposit inflows are somewhat above year-ago levels. Deposit inflows have changed little since November and are expected to improve slightly during the first quarter. Mortgage demand remains weak, although some respondents foresee a pickup in activity in the spring. Mortgage rates have been stable, with little change expected in the near term.

Banking. Respondents at district banks report slightly higher total loan demand for the month. Demand for commercial and industrial loans and consumer loans is up slightly, while demand for residential and commercial real estate loans and agricultural loans is unchanged on average. The prime rate remains unchanged among all respondents, with only one respondent

expecting a slight decline in the future. Consumer loan rates are unchanged and expected to remain at current levels. Total deposits rose slightly because of small increases in the demand for conventional and super NOW accounts, demand deposits, MMDAs, and small time deposits. Large CDs were down slightly, while IRAs and passbook savings accounts were about unchanged.

Agriculture. Strong livestock prices, a good fall harvest and substantial government payments produced relatively high farm incomes for 1987. As a result, 1987 year-end loan repayment rates at agricultural banks were generally high, showing some improvement over a year ago. Some bankers also report that they expect borrowings for 1988 to be down, as cautious farm borrowers are putting more cash earnings into operations. Most agricultural lenders continue to look for sound borrowers as loanable funds remain readily available and demand for loans weakens.

Farm machinery sales are also beginning to reflect an improved farm income situation in the district. After two relatively stable years for farm incomes, some operators are now upgrading worn equipment. The used machinery market has shown more activity, but high prices and a cautious outlook are still keeping many farmers out of the new equipment market.

Although livestock prices have contributed significantly to the strength in farm income, there has not been much expansion in district livestock operations. Feedlots in the region remain full, but cow/calf operators are reluctant to hold back high priced heifers to increase breeding herds. High cattle prices have also forced the price of replacement animals up, causing some stocker cattle operations to actually reduce herds. Most district hog growers have been running at capacity, but there has been little facilities expansion. The recent downturn in hog prices has not yet had a visible effect on district hog operations.

ELEVENTH DISTRICT--DALLAS

The District economic expansion continues, led by manufacturing growth, but some other sectors are showing renewed weakness. Drilling is decreasing. New construction activity is declining. Retail sales strengthened late in the holiday season, but auto sales are very weak. Total deposits at District financial institutions remain below a year earlier. Unusually widespread and heavy snowfall has caused severe damage to District agriculture.

Most District manufacturers report continued expansion in orders. The principal exception is construction-related industries, where sales are declining or are unchanged at low levels. Manufacturers of chemicals and of refined petroleum products cite strong orders and expect growth in the first quarter. District apparel producers say their sales are increasing and some firms are adding to their workforces. Defense contracts let to District manufacturers have been increasing lately and defense contractors in the District say they anticipate continued high levels of production in 1988. Respondents in industries tied to oil and gas drilling report slight increases in orders and product prices, but they say that profit margins remain low. Production of electric and electronic equipment is growing at a modest pace, while steel production is growing strongly.

The District drilling rig count fell moderately on a seasonally adjusted basis in each month of the fourth quarter. Recent declines in well permit applications, a leading indicator of drilling, point toward further declines in District drilling. A number of analysts are becoming increasingly bearish about energy prices.

District construction activity has been declining. In October and November, the value of construction contracts fell substantially from its third-quarter average. Declines in new residential and nonresidential construction more than offset the increasing values of nonbuilding construction contracts. Most of the additional weakness in residential building was in single-family homes. Despite recent declines in construction contract values, construction employment has been growing in recent months.

District retailers say that holiday sales were higher than they had expected, but they noted that the gains came at the expense of deep markdowns. The majority of retailers reported year-over-year nominal gains in the 3 percent to 7 percent range. District apparel sales did not grow as rapidly as those of other traditional gift items, however.

District auto dealers report substantial dropoffs in sales. Respondents attribute the weakness to sluggishness in the District economy and to heightened consumer uncertainty. Several firms said they believed that consumer uncertainty has risen in the District because of renewed weakness in oil prices and because of growing concerns over the possible imminence of a national recession. Dealers also say that prices of imports are continuing to rise and that inventories of imports are far above desired levels.

Total deposits at the District's financial institutions remain below year-earlier levels. The weakness in deposits is focused on continuing declines at the commercial banks. District thrifts report year-over-year increases in deposits, despite declines in transaction

deposits, nontransaction savings deposits, and large time deposits. Small time deposits are growing at the thrifts. Regulatory net worth at Texas thrifts continues its steady decline, after initially having fallen into the negative range in January 1987. Business and real estate loans at large District banks are decreasing at accelerating rates. In the fourth quarter, large District banks' holdings of securities also fell below a year earlier.

District agriculture has suffered severe weather damage in recent weeks. Snow damaged some unharvested cotton and it also collapsed large numbers of poultry sheds. Current estimates are that a half-million birds perished as a result of these collapses. The Texas All Crops Price Index was up 11 percent in December from a year earlier, but it declined by 2 percent from November's level. The Texas Livestock and Livestock Products Price Index in December was 8 percent above a year earlier, but was unchanged from November. Price increases for poultry are widely expected in the wake of the snow damage to poultry operations. Analysts generally expect real net cash farm income in the District states to be lower in 1988 because of falling revenues from cotton and livestock production.

TWELFTH DISTRICT -- SAN FRANCISCO

Summary

The Twelfth District economy continues to exhibit good health overall. Retail sales during the Christmas season appear to have registered modest increases, of about 5 percent, over last year's levels. Manufacturing, agriculture, and forest products industries continue to show improved sales, with much of the growth attributed to exports. Construction activity, however, is flat or down in many parts of the West, as builders wait for current inventories to be sold. Lending activity shows mixed trends. For most western banks, the number of mortgage applications is higher than it was earlier in the fall, but below last year's levels, while installment lending is on a downward trend. Few bankers noted changes in lending patterns that they attributed to the stock market decline last October.

Consumer Spending

Reports suggest that Twelfth District retailers experienced sales gains averaging around 5 percent over last year's Christmas season, with a range of zero to 10 percent. For several stores, sales gains were close to the original plans made before October 19. Many respondents said that price cuts were deeper and earlier this year than they were last year, but several others reported discounting patterns similar to those of previous years. Reports on retail inventories were mixed, with about equal numbers of respondents reporting higher and lower inventories compared with last January.

Car sales are reported to have been slow in December in most parts of the District, and many dealers have accumulated inventories compared with three months ago and with year-earlier levels. One banker noted strong demand for boat loans through late fall, although there was a normal seasonal slowdown in December.

Manufacturing

Manufacturing activity continues to strengthen in the West, buoyed by the lower foreign exchange value of the dollar. Some respondents reported sharp increases in foreign equipment prices during early January. In addition, aluminum producers in the Northwest are enjoying a surge of activity generated by a combination of higher aluminum prices, lower wages, and a favorable electric rate schedule recently negotiated with the Bonneville Power Administration. Airplane inventories at western aerospace companies are very lean, due in part to strong export demand. Currently, one large firm has more than two years' worth of orders for commercial aircraft on its books.

Agriculture and Resource Related Industries

Energy sector activity in the West remains higher than it was a year ago. In 1987, oil service firms posted losses equal to 4 percent of sales, an improvement over the dismal performance of 1986. Although the recent price decline did not reduce the demand for oil services, it did dash hopes of further gains. At present, industry observers expect drilling plans to remain stable if prices stay at or above \$15 per barrel.

Inventories are very lean in many export-oriented firms that produce paper, plywood, lumber, and logs. Drought-related logging restrictions have exacerbated the inventory tightness, so that log inventories stand at only 30 to 40 percent of their normal levels. The importance of export-related demand to these firms is illustrated by a major wood products firm, active only in the domestic market, which is experiencing just moderate growth, and is maintaining merely ordinary inventory production and inventory levels.

Many agricultural products also have seen strong exports in recent months. For example, wheat exports are up 25 percent compared with a year ago. Inventories of some western crops are slightly higher than they were a year ago, due primarily to

higher 1987 yields. Inventories of principal California crops (almonds, cotton, rice) are expected to fall quickly due to the strong export activity.

Wine inventories are down, partly due to substantially lower imports, but also due to low grape yields last fall.

Construction and Real Estate

Construction activity is relatively sluggish in most parts of the West. In Arizona, housing starts are down nearly 40 percent, with multifamily construction at a virtual standstill. In contrast, the strong export-led growth in the coastal areas of the Pacific Northwest has buoyed both housing starts and commercial construction in that area.

Financial Sector

Mortgage applications in December were down from their year-earlier levels in most parts of the District, but some bankers pointed out that the strong refinancing activity of a year ago accounts for much of the decline. Some bankers reported increases in mortgage applications between the third and fourth quarters of 1987, which they attributed to the decline in long-term interest rates. However, one banker noted a substantial decline in the number of requests for new construction loans compared with six months ago and with a year ago. Several bankers reported that demand for home equity loans was strong throughout 1987.

Applications for consumer installment loans also were below their year-earlier levels at many western banks. In the Seattle area, one banker reported installment loan applications up about 2 percent from last year which, although better than most banks' experiences, represents a marked deterioration from the 13 to 14 percent growth rate this bank registered a year earlier. Several bankers noted no discontinuities in credit patterns associated with the stock market decline in October, although a few argued that the October crash reduced loan demand dramatically.