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Summary of Commentary on

Current Economic Conditions

by Federal Reserve District

August 1999

SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS BY FEDERAL RESERVE DISTRICTS

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SUMMARY*

District reports indicate continued strength in economic activity, though there are widespread reports of supply constraints. Retail sales, which had been robust in the second quarter, decelerated somewhat in July, in some cases due to low inventories of clearance merchandise. Manufacturing activity continues to expand in most parts of the country, though a few districts indicate some softening. Performance has varied substantially by industry: electronics, heavy trucks and construction materials continue to exhibit strength, while textiles and metals remain weak. Residential construction and housing markets remain strong in most districts, though in some areas shortages of materials, labor, and available land have constrained home construction, delayed projects and boosted costs. Commercial real estate markets remain tight in most districts; building is mixed but generally strong. Tourism has generally been strong, especially in the Middle and South Atlantic seaboard regions.

Loan demand is steady or rising in most districts. Although there has been some decline in residential mortgage lending, and especially refinancing activity, demand for commercial and industrial loans, as well as consumer (largely auto) loans, continues to grow briskly. Expectations of large Midwest harvests have depressed grain prices, but drought conditions are hurting crops in the eastern part of the country. The energy sector has shown some signs of improvement in recent weeks, as oil prices have continued to climb, but the level of drilling activity remains sluggish and lower than a year ago.

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* Prepared at the Federal Reserve Bank of New York and based on information collected before August 3, 1999. This document summarizes comments received from businesses and other contacts outside the Federal Reserve and is not a commentary on the views of Federal Reserve officials.

Widespread labor shortages persist in virtually every district, but there have been only scattered reports of an actual acceleration in wages. Final prices of goods and services remain relatively stable for the most part. There are some reports of accelerating prices—largely related to home construction—but there is no evidence of any broad-based pickup in consumer price inflation.

Consumer Spending

July retail sales were characterized as strong in most districts, but the pace of growth appears to have eased since the last report. While sales continue to run higher than a year ago in all districts, activity has slowed somewhat in New York and Dallas—partly due to low clearance inventories—and has held steady in Kansas City. Overall, retail inventories are generally at desired levels. However, lean stocks of summer merchandise, most notably air conditioners, are reported in New York and Philadelphia. Contacts in Philadelphia, Cleveland, Richmond, Kansas City, and San Francisco express optimism that consumer spending will continue to be strong in the months ahead.

Automobile sales continue at high levels in most parts of the country. In July, robust vehicle sales are reported in Cleveland, Richmond, Minneapolis, Dallas, and San Francisco. Dealers in Cleveland report low inventories, with certain models sold out. However, auto dealers in Philadelphia and Chicago say that sales slowed, following very brisk activity in June.

Manufacturing

Overall, manufacturing activity has been expanding in most districts, though Atlanta, Chicago, and Kansas City report some slowing. Manufacturing-sector performance varied considerably by industry. Output of industrial equipment and home-construction materials has been expanding briskly across most of the country, though there are scattered indications that growth is being limited by shortages of raw materials and labor. Boston, Cleveland, Dallas, and San Francisco report strong demand for electronic (computer/telecommunications) equipment; Cleveland and Chicago indicate strong orders for heavy trucks. There are also reports of strength in medical equipment (Boston), furniture (Richmond), and chemicals (Dallas).

Weak or declining activity is reported in metals industries in Philadelphia, Chicago, and San Francisco, and in the textile industry in Philadelphia, Richmond, and Atlanta. Other reports of weakness come from makers of machine tools in Boston and San Francisco, farm equipment in Cleveland and Chicago, and commercial aircraft in St. Louis and San Francisco. Manufacturers in the west—Dallas and San Francisco—report some pickup in exports to Asia; producers in the Boston district see only scattered signs of improvement in Asian markets.

Real Estate & Construction

Housing activity continues at a vigorous pace in most districts, though supply constraints are limiting growth in many areas. Boston, New York, Philadelphia, Cleveland, St. Louis, and Minneapolis indicate persistent strength in residential real estate. Chicago, Kansas City, Dallas, and San Francisco report that housing activity slowed somewhat in July. New York and Richmond indicate that the recent rise in mortgage rates has not adversely affected the housing market and may have prompted some buyers to act.

Shortages of materials, labor and land are hindering construction and delaying projects in some areas. Land shortages are cited in New York and Atlanta. Labor shortages are indicated in New York, St. Louis, Chicago, Dallas, and San Francisco—mainly for skilled tradespeople, such as carpenters, framers, and masons. Many districts also report problems in obtaining key construction materials, most notably drywall, insulation and bricks. Home sales in Boston, New York and Atlanta are being limited by construction bottlenecks, combined with low inventories of existing homes.

Commercial real estate markets remain tight in most areas. St. Louis indicates a pickup in activity, while New York, Richmond, Chicago, Atlanta, Dallas, and San Francisco report that conditions are steady and strong. However, some contacts in the Cleveland and Dallas districts, though pleased with current conditions, express concern that vacancy rates have begun to rise.

Tourism and Services

Tourism has generally been very strong. Philadelphia, Richmond, and Atlanta note that summer resort areas are having an exceptionally good year; New York reports that hotel business has held steady at a high level through the first half of 1999. Boston and San Francisco cite a decline in international visitors from Asia and (in Boston's case) from Canada. Districts reporting on other non-retail service industries—Richmond, Dallas, and San Francisco—indicate that they are in good shape.

Financial Services

Banks in most districts report that overall loan demand is steady or growing, despite a dip in demand for residential mortgages. Atlanta, Chicago, and Kansas City indicate increasing loan demand, while New York, Philadelphia, Cleveland and Dallas report that demand is flat, on balance. By contrast, St. Louis district banks report declining loan demand, though this is largely attributed to a loss of share by banks in the mortgage market. Strong growth in commercial and industrial loans is reported from Philadelphia, Richmond, Atlanta, Chicago, St. Louis, and Kansas City. Consumer lending is reported to be strengthening in the Atlanta, St. Louis, Kansas City and Dallas districts but flat in New York and Cleveland. However, residential mortgage lending is generally weaker in Richmond and Dallas, as well as St. Louis. Declines in refinancing activity are reported in New York, Richmond, Chicago, and Kansas City.

Credit quality appears to have improved, on balance, since the last report. New York, Cleveland and Chicago note an improvement in overall credit quality, while Atlanta and San Francisco indicate little or no change. Lending standards are mostly unchanged, though New York and Cleveland report some tightening in standards.

Agriculture, Mining, Natural Resources

Hot and dry weather in the eastern part of the country has caused some crop damage, but crops are generally reported to be in good shape in the interior regions. Philadelphia and Richmond report that drought conditions are severely hurting this year's corn and soybean crops. Cleveland, Chicago, and St. Louis report that the corn and soybean crops are generally in good condition, but pasture conditions are poor. Expectations of a large harvest have depressed prices, hurting farmers' incomes. In Minneapolis, Kansas City and San Francisco, wet weather has hindered output of some crops.

The recent rise in oil prices has boosted activity in the Kansas City, Dallas, Minneapolis and San Francisco districts, though rig counts are still said to be well below last year's levels. Dallas reports that most of the increase in activity is in small, low-risk projects, while major projects (off-shore and foreign drilling) continue to trend down.

Labor Markets, Wages, Inflation

Virtually all districts report widespread labor shortages, but most indicate that overall wage growth remains subdued. There are severe shortages of skilled construction workers—particularly carpenters and brick masons—in most districts. Excess demand for computer and information technology workers is reported in Cleveland, Richmond, Atlanta, Kansas City and Dallas; however, Chicago notes some slackening in demand for Y2K staff. Retailers, including restaurants, report labor shortages in New York, Philadelphia, Richmond and Kansas City. San Francisco notes a shortage of seasonal agricultural workers.

Despite the labor shortages, none of the districts reports evidence of any broad-based acceleration in wages. Still, there were scattered reports of accelerating or rapidly-rising wages—in biotechnology (Boston), construction (New York, Kansas City, San Francisco), retail (Philadelphia, Richmond), health-care (Atlanta), and transportation (Minneapolis). In addition, strong wage increases for office workers with technical skills are reported in Chicago and Kansas City. Aside from boosting wages, businesses are dealing with labor shortages in various ways: retailers in Boston are expanding performance-based compensation; businesses in Cleveland are providing job security commitments; truckers in St. Louis and builders in Kansas City are increasingly recruiting internationally and (in the latter case) using signing bonuses more than in the past.

Consumer prices remain relatively stable, despite some apparent intensification in input price pressures. Manufacturers in New York, Philadelphia, and Chicago indicate a general increase in input costs, although those in Boston report flat to declining input prices. A number of districts indicate an acceleration in prices for certain materials—particularly construction materials such as drywall, lumber, bricks and insulation materials, as well as energy and transportation costs. Also, steel and paper prices, though low, have turned up recently. Agriculture and livestock prices, however, remain weak and are mostly down from a year ago.

There is no evidence of any broad-based acceleration in prices of finished goods and services. Retailers in Boston, New York, Atlanta, Chicago, Minneapolis, and San Francisco report stable prices, while those in Philadelphia, Richmond, Kansas City, and Dallas indicate modest increases. Hotel room rates have risen noticeably in Boston but have leveled off in New York following sharp rises last year.

FIRST DISTRICT-BOSTON

Economic activity in the First District continues its expansion. Area manufacturers report positive results more consistently than they did earlier in the year and retailers say sales growth is still strong. Most employers indicate labor markets are tight, but general wage increases remain in the 3 to 5 percent range. With limited exceptions, prices are generally level or down.

Retail

Most retail contacts report sales growth in the middle single-digit range in June and July, in line with projections for the period; they characterize these results as "strong." Inventories are considered to be at desired levels. In the tourism sector, revenues continue to grow, but at a slower pace than earlier in the year.

Retail contacts generally report that employment is holding steady and wages continue to rise at a 3 to 5 percent pace; total compensation costs are increasing somewhat faster than wages. All respondents say that the labor market is very tight, but that the tightness is not causing generalized wage growth because of a shift in compensation packages toward performance-based incentives. Competition for employees is taking place via more liberal incentive packages rather than higher base pay. Contacts also state that the tight labor market is not constraining their operations.

Consumer price inflation is reported to be almost nonexistent as competitive pressures continue to restrain prices. Two notable exceptions are lumber prices and hotel room rates, both of which are rising. Weakness in international markets continues to drive down vendor prices, so merchandise purchasing costs are either holding steady or declining. As a result, gross margins are said to be either increasing slightly or holding steady.

The slower growth in tourism is attributed to two shifts: smaller increases in bookings from international tourists (primarily from Asia and Canada) and a drop in domestic leisure tourists. The explanation offered in both cases is the high cost of hotels in the Boston regional market.

Retailers indicate that capital expansion plans have not changed since early this year. All contacts report significant expansion in the e-commerce area. Looking forward, most contacts say that economic fundamentals are strong and that they expect steady economic growth to continue for the next six months, barring major policy changes.

Manufacturing and Related Services

Most First District manufacturing contacts report that recent business is up relative to a year ago. At the high end, companies cite double-digit growth in demand for medical equipment and related services, pharmaceuticals, telecommunications equipment, integrated circuits, and automotive equipment. A paper company has returned to more normal operations after being severely hurt by the Asian crisis. A manufacturer of consumer items reports that industry-wide sales had slowed earlier as major retailers installed new inventory-management systems; sales at his company have now resumed growing although he believes retail inventories have permanently shrunk. A manufacturer of residential construction components reports that business was disrupted this spring because of temporary shortages of basic materials such as concrete, drywall, and insulation. On the other hand, the demand for machine tools continues to slump and makers of non-automotive transportation equipment indicate sharply deteriorating orders. Some capital goods suppliers have yet to see a turnaround in Asia.

Manufacturers indicate that input costs remain mostly flat or down, in part because of pressures buyers are exerting on suppliers. However, some contacts mention they are paying more for construction-grade lumber, oil-based products, copper, and steel. Selling prices also are mostly flat or down, with the exception of increases for construction products and modest upturns from cyclical lows for paper and integrated circuits.

Most contacts continue to report average pay increases in the range of 3 to 5 percent and steady or declining headcounts. However, at an expanding biotech firm, pay raises are said to be twice this norm and recruitment has become more challenging. A couple of other contacts report a shortage of manual labor, but they differ on whether wage pressures are increasing. By contrast, another employer, experiencing significant layoffs, reports that most continuing workers will get no raise at all while new hires receive very attractive compensation packages.

Manufacturers report very mixed capital spending plans. At one extreme, some companies in troubled industries indicate they will spend almost nothing this year; at the other extreme, companies are doubling capital expenditures in order to become more efficient or expand capacity.

Various manufacturers point to recovery in Asia as a positive factor in their outlook. However, half of the contacts cite idiosyncratic factors that will limit their revenue growth, and some now see a need for greater emphasis on controlling costs.

Residential Real Estate

The residential real estate market in New England remains active. Low inventory levels continue to be the major problem in most areas. Higher interest rates and a lack of inventory are blamed for a reported decline in home sales in Massachusetts in the first half of 1999 compared to the same period last year. Contacts view the drop as "leveling off" after a year of record sales, and predict that 1999 is going to be another strong year. Several respondents report price increases, driven in part by high demand for expensive second homes in Massachusetts, New Hampshire, and Vermont; they anticipate much slower price appreciation in the next few months. Hartford is said to be seeing slight, selective price appreciation in both the city and the suburbs. In New Hampshire, the average selling price in the second quarter exceeded its 1980s peak.

Investment management

First District investment management companies indicate they are continuing to add employees as their assets expand. Because of tightness in the labor market, they report raising entry-level salaries and continuing to pay referral bonuses to current workers.

SECOND DISTRICT--NEW YORK

The District's economy continues to expand, though at a somewhat slower pace than in the last report. There are indications of an increase in wage and price pressures in some key sectors. Most retailers report that sales retreated to more normal levels in July, following exceptionally strong activity throughout the second quarter. Manhattan's office market tightened further in the second quarter, but commercial real estate appears to have softened in most of the outlying suburbs. Housing demand continues to strengthen—especially in the New York City area, where builders and realtors report sharp price increases and cite lack of inventory as the number one problem.

Regional purchasing managers report steady growth in manufacturing in July, along with increased price pressures. The merger of Conrail into CSX and Norfolk Southern has caused persistent shipping delays, though they were said to be less severe in July than in June. Banks report a normal seasonal dip in loan demand, some tightening in credit standards, and little change in delinquency rates.

Consumer Spending

Retailers report that sales slowed to a more normal pace in July, following an exceptionally strong second quarter. Most chains report that sales were close to plan in July—comparable-store sales rose 6-8 percent from a year earlier at discounters but more modestly (0-5 percent) at general merchandise stores. Contacts note that July is largely a clearance month and that lean inventories limited sales. Unusually hot weather throughout the District reportedly buoyed sales of summer merchandise but held back fall clothing; on balance, weather was seen as having little or no effect on total sales. In general, the strongest sales categories were home goods and women's casual apparel.

All retailers report that inventories were in very good shape at the end of June, and that there was less discounting in July than last year. Major chains report that selling prices and merchandise costs have leveled off, after declining in 1998 and early 1999. Most retailers report increased difficulty in finding and retaining workers but add that the real test will come during the peak Christmas season.

Construction & Real Estate

Housing markets are tight, especially in the southern tier of the District. On a seasonally-adjusted basis, housing permits in New York and New Jersey rose substantially in June, led by a surge in multi-family construction in Long Island and northern New Jersey. Single-family permits rose moderately but remained below lofty first-quarter levels. For the second quarter as a whole, single-family permits were up 7 percent from a year earlier, while multi-family permits were up 50 percent.

Anecdotally, realtors and homebuilders across the New York City metropolitan area report brisk demand, double-digit price appreciation and widespread bidding wars; they cite supply shortages as the housing sector's number one problem. Contacts in the construction industry report that shortages of skilled workers (particularly carpenters and framers), rising costs of insulation materials and drywall, and sharply rising land costs have all put upward pressure on new home prices. An industry contact in northern New Jersey notes that, with demand strong and inventories lean, there is a more than 7-month wait for new homes; he also says that the recent rise in mortgage rates "has only intensified the buying frenzy." Similarly, a major Manhattan realtor describes the market as "phenomenal," with total sales volume up 40 percent from a year ago. Market conditions in upstate New York appear more subdued but still favorable, with an Albany-area builder describing supply and demand as "balanced."

Commercial real estate markets were mixed in the second quarter. Manhattan's office markets tightened further, as vacancy rates fell to cyclical lows at the end of June—Midtown's rate fell from 7.7 to 7.2 percent, while Downtown's rate decreased from 12.0 to 11.6 percent. Similarly, Long Island's vacancy rate edged down to a record low of 8.9 percent in the second quarter. However, in most of New York City's suburbs—northern New Jersey, Westchester and Fairfield—vacancy rates rose. Office rents across the metropolitan area have been fairly stable so far this year, after rising sharply in 1998.

Other Business Activity

Regional purchasing managers' surveys indicate steady growth in manufacturing activity in June and July, along with increased upward price pressures. New York purchasing managers report that manufacturing activity expanded at a brisk pace in both June and July, following a dip in May. Buffalo-area purchasers report that production activity grew at about the same modest pace in July as in the second quarter, while new orders and employment levels were little changed. Surveys in both these areas indicate a noticeable pickup in prices for manufacturing inputs.

There have been reports of significant shipping delays due to the merger of Conrail into CSX and Norfolk Southern, though contacts do not see any problems comparable to last year's merger between Union Pacific and Southern Pacific. One contact at a short-line railroad in upstate New York says that, while delays persisted in July, they were not as bad as in June; conditions are expected to be back to normal by around the end of October. Some shipping has been diverted to trucks, but not much.

Hotel occupancy rates in New York City held steady throughout the second quarter at just above 80 percent—a high level but about 5 points lower than a year earlier. After registering double-digit increases through much of 1998, room rates are currently running just 2 percent higher than a year ago.

Financial Developments

According to the latest survey of senior loan officers, small and medium sized banks in the Second District indicate a normal seasonal decline in loan demand. Refinancing activity continued to fall over the last two months, with 35 percent of bankers indicating a decrease in activity. Bankers report some tightening in credit standards over the last two months, particularly on commercial and industrial loans. Bankers report increases in deposit and loan rates—most notably on residential mortgages. Several respondents volunteered that they had raised rates in response to higher market rates. Delinquency rates were generally steady to slightly lower over the past two months.

THIRD DISTRICT – PHILADELPHIA

Overall business activity in the Third District advanced moderately in July, and consumption spending appeared to be robust. Manufacturers posted slight gains in shipments and new orders. Retailers reported an increase in total sales from a year ago and a surge in sales of summer merchandise. Auto dealers said sales were strong in June, although there was a seasonal slowing in July. In general, bankers indicated that loan volume has been steady. Increases in business lending have been offset by decreases in consumer lending. Real estate lending was mixed. Mortgage and home equity loans have risen, but there has been some scaling back in commercial real estate lending. Tourism and recreation business in the region has been strong. Tourism officials indicated that spending for lodging, meals, and recreational activities in most resort areas so far this season has been at its highest level in a decade. Farming has suffered from drought conditions.

Forecasts by Third District businesses contacted for this report are positive, although expectations for growth appear to have moderated. Manufacturers anticipate a slow expansion during the rest of the year. Bankers expect current trends in lending to continue, but they expect a slower pace of overall economic growth that could result in loan payment difficulties for some borrowers. Retailers are more optimistic. They believe a high level of consumer confidence will encourage spending during the fall shopping season. Auto dealers also expect sales to increase in the months ahead.

MANUFACTURING

Third District manufacturers reported modest growth in business during June and July. In most of the major goods-producing sectors in the region, the pace of growth appears to have slowed from the first half of the year. Although the current rate of new orders is up slightly for the sector as a whole, declining orders were reported by manufacturers of textiles, paper products, primary metals, and stone, clay, and glass products. Producers of chemicals have seen a recent improvement in business, but some still report sluggish growth due to a slow rate of increase in demand and worldwide overcapacity. On the whole, the region's manufacturers reported a drop in order backlogs and a shortening in delivery times resulting from the slower growth rate, but they indicated that inventories have been reduced slightly.

The consensus among the manufacturers contacted for this report is that business activity will move up slowly in the second half of the year. They expect modest increases in orders and shipments and a further decline in order backlogs. Several firms supplying metal parts and electrical equipment to the transportation and capital goods industries indicated that production in these sectors is expected to ease in the near future. Overall, industrial firms in the region expect to trim employment in the next six months, cutting back both the number of employees and working hours.

Reports of rising input prices in the region's manufacturing sector have become more common. Prices have increased for primary metals, lumber, and paper as well as for some basic commodities used in food processing and textile production. However, firms in these industries continue to note that competition is limiting their ability to pass increases in input prices through to the prices of the products they make.

RETAIL

Third District retailers gave positive reports for July. Sales were up from the year-ago pace for most lines of merchandise. Store executives said the hot weather the region has been experiencing gave an added boost to sales of summer apparel, swimsuits, and air conditioners. Several stores have sold out their inventories of air conditioners, and many reported that inventories of summer items in general were low by mid-July. Inventories of other types of goods were said to be in line with sales.

Merchants expect a seasonal slowing in the rate of sales for August prior to the back-to-school shopping period. Retailers said consumer confidence remains strong, and they expect a good fall season. Tight labor markets and some escalation of wages are causing concern among retailers. They continue to look for ways to improve efficiency in store operations in order to limit price increases, as competition among stores remains strong.

Auto dealers reported strong year-over-year sales increases in June. The growth rate of sales of sport utility vehicles slipped somewhat, but sales of luxury sedans increased. Dealers noted some slowing in overall sales in July, but they believe this is a seasonal pause; they expect sales growth to resume soon, and they anticipate a healthy sales rate in the second half of the year.

FINANCE

Loan volume outstanding at Third District banks has been virtually level in recent weeks, according to reports from bank credit officers. A few banks indicated that they were posting gains in commercial and industrial loans, but some slippage in consumer lending has kept total loan volume from rising. Real estate lending has been mixed. Some banks were increasing mortgage and home equity lending, while others were trimming loans to residential and commercial real estate developers.

Looking ahead, bankers contacted for this report expect the current level of loan demand to persist unless interest rates move up. Competition among lenders for both consumer and business lending remains strong. Some bankers believe competition has resulted in an increase in loans to marginally qualified borrowers. These bankers have expressed concern that such borrowers may face repayment difficulties if business conditions weaken.

TOURISM

Tourism officials around the region have reported very high levels of tourist, lodging, and recreational activity. Retail sales in tourist areas were also said to be strong. Several contacts at beach resorts in New Jersey and Delaware and at mountain resorts in Pennsylvania said business was at a 10-year high. Real estate activity in these locations has been on the rise. Increases were reported in rentals, second home purchases, and time-share contracts. Businesses in resort areas indicated that they have been unable to meet their needs for workers. Operators of stores, restaurants, and other businesses fear conditions will worsen in August when many of their employees return to school.

AGRICULTURE

Several weeks of hot, dry weather have damaged crops throughout the region. Agriculture officials were assessing the damage during the first week in August, and early indications were that losses would be high, especially for field crops such as corn and soybeans.

FOURTH DISTRICT - CLEVELAND

Labor Markets

District employment agencies continue to have difficulty finding enough bodies to fill the positions available. Agencies report that demand for temporary workers is significantly higher than this time last year, with administrative assistants and computer support personnel in especially short supply. Wage growth at temporary help agencies varies by region. The largest wage increases are reported in southern Ohio.

Tight labor markets have helped push up collective bargaining settlements slightly for all industries except mining. Overall wage increases vary from 3% to 3 3/4%. However, concern over job security is reportedly easing wage pressures—some sources indicate having forgone wage gains in favor of a commitment on employment. No wage growth is reported in the mining sector, which continues to suffer reversals, as low oil prices and environmental legislation have cut into the industry's growth rate.

Construction

Residential construction activity remains brisk throughout the District. One contact reported sales for 1999:QII that were 15% above the same period a year ago. Commercial construction remains essentially unchanged from the spring and less frenzied than residential construction. While business conditions here are generally considered good, some concern was expressed over slack orders for year-end commercial building.

Construction cost increases are generally modest, although drywall and lumber prices are rising due to short supply. Labor costs are relatively stable, but contractors continue to have difficulty finding workers in the skilled trades.

Agriculture

Low prices and a lack of rain have put pressure on the District's farming sector. Drought conditions exist in the eastern half of the District. Livestock farmers report poor pasture conditions. As a result, farmers have had to deplete their winter hay stores. Dairy farmers also indicate that high temperatures in July have hindered milk production.

Crop conditions are more favorable in the western reaches of the District, although conditions could change significantly over the next several weeks without additional rainfall. The corn and soybean crops have developed ahead of schedule and remain in relatively good shape. Still, crop prices are exceptionally low, presumably due to weak export markets, and many farmers are receiving federal crop subsidies.

Industrial Activity

Industrial activity is still gaining strength following some softness earlier in the year. Capital goods makers report generally good orders' growth. Heavy truck manufacturers see record-high orders and production, and the orders' books in this industry are virtually full for at least the remainder of the year. Solid orders growth is also noted for telecommunications components. Some weakness in farm equipment manufacturing is seen, however. No significant changes are reported in the steel industry for July. Steel demand remains adequate as a result of strong auto production and construction activity. Foreign competition remains fierce, although the falling value of the dollar appears to have helped to slow the growth rate of steel imports.

Commodity price increases vary widely by item and industry, although most manufacturers observe more upward pricing power than earlier in the year. Significant upward price movements are seen in paper and aluminum.

Consumer Spending

Retail sales are still growing and many sellers report double-digit gains over last year. Most of the retailers we contacted expressed optimism that sales will remain strong through the holiday shopping season. In an effort to insure against potential Y2K-related delays from foreign suppliers, some stores have accelerated their orders from abroad.

Sales of new vehicles have shown no sign of moderating during the traditionally slow summer season. Dealers often reported sales levels up 10% to 15% over last year, and this pace is expected to hold through the end of the model year. The rapid sales pace has resulted in lower-than-usual inventory levels at most dealerships. Some dealers report a model-year sellout of some vehicles, including some full-size pickups.

Banking and Finance

Lending activity in the District appears to have leveled off for both commercial and consumer loans. The growth rate of consumer loan demand has flattened, and borrowing rates have risen a bit during the past six weeks. Demand for commercial loans is soft, overall, although one bank reported an increase in small business lending.

Consumer and commercial loan delinquencies, already at low levels, improved further over the last six weeks. Most banks reported that credit quality has improved as a result of tightened lending standards. Still, the competition for borrowers is very tight and the spread between borrowing and lending rates is narrowing.

FIFTH DISTRICT – RICHMOND

Overview: Fifth District economic activity advanced at a brisk pace in June and July. Retailers reported strong sales, particularly of automobiles, furniture, and apparel. Business services and tourism revenues strengthened, and District manufacturers stepped up production and hiring. At financial institutions, higher interest rates slowed mortgage lending but had little effect on the pace of commercial lending. The real estate sector remained generally strong; home sales advanced at a rapid pace and prime commercial property continued to be highly sought. Wages accelerated slightly in the retail sector but remained moderate in other sectors. Prices of manufactured goods were generally flat and other prices rose only modestly.

Retail: Retail sales surged in June and carried some of that momentum into July, driven by a pickup in big-ticket purchases. Automobile dealers said July was a particularly strong month; showrooms were busy and sales exceeded expectations. Furniture and apparel sales also grew faster in recent weeks. In contrast, sales at home centers and do-it-yourself stores weakened. Qualified retail workers remained difficult to recruit, resulting in a slight acceleration in wage growth over the last two months. A Charlotte, N.C., department store manager told us she was "willing to pay for quality workers but just couldn't find any." Prices at retail stores increased at a modest rate in June and July. Looking ahead, retailers anticipated strong demand for their merchandise over the next six months.

Services: Revenues at service firms expanded briskly since the last Beige Book; business services and tourism receipts were especially strong in July. A Washington, D.C., hotel manager credited high levels of consumer optimism for his firm's exceptional receipts in recent months. In residential real estate, firms benefited from the decisions of "penultimate fence-sitters" to purchase a house now rather than risk higher mortgage rates later. Service firms added employees at a slower pace, in part because of a scarcity of technology-trained workers, but also because some firms anticipated a slowing of demand.

Manufacturing: District manufacturing activity generally strengthened since our last report, but pockets of weakness remained. Shipments, new orders, and capacity utilization all rose more quickly in recent weeks. Production at industrial machinery, furniture, and printing and publishing firms was notably higher. An industrial machinery producer in South Carolina told us that an increase in electric utilities' demand for gas turbines would likely double production at his firm this year and triple it next year. In contrast, textile mills continued to lose market share; a textile producer in North Carolina said that his firm would soon lay off nine hundred workers as the company "shifted away from textile production and concentrated on other business lines." Manufacturing employment and the average workweek increased in recent weeks, but wages grew somewhat more slowly. Manufacturing prices were little changed; a contact at a food processing plant in Virginia said that recent price increases were "not holding" due to resistance in the marketplace.

Finance: District bankers reported that, while commercial lending remained generally strong in June and July, residential mortgage lending was slowed by higher interest rates. Robust business expansion continued to drive commercial loan demand; in the words of a Chesapeake, Va., banker "business deals are moving forward despite higher interest rates." However, residential mortgage lending stalled in recent weeks and mortgage lenders were less optimistic regarding near-term prospects. A Charleston, S.C., mortgage lender told us that business in his office had declined 25 percent in the last month while a lender in Greenville, S.C., noted that the slowdown in lending activity was "greater than expected." Several bankers reported that mortgage refinancing activity was sharply lower.

Real Estate: Reports from residential realtors and builders were mixed. Some builders and realtors said that new construction and sales had flattened, though the level of activity remained higher than normal. Other contacts, however, reported continued growth in housing sales in their areas. In Richmond and northern Virginia, expanding residential construction and sales were still generally being reported. In contrast, slower growth in home sales was reported in South Carolina. Shortages of drywall and brick continued to plague builders and the prices of drywall, insulation, and plywood rose further. In addition, builders across the District told us that their subcontractors continued to have difficulty finding qualified workers, particularly framers and brick masons. Wage increases, however, remained relatively modest.

Commercial real estate activity remained strong in recent weeks. Realtors in the Washington, D.C., area and in parts of North Carolina said that it was increasingly difficult to locate large blocks of Class A office space. A Raleigh, N.C., realtor said that he was busier now than four months ago as existing businesses continued to expand. According to him, entrepreneurial businesses and individuals had filled Class B space almost to capacity. In Washington, D.C., however, a realtor noticed a four-fold increase in available small rental space blocks, which he attributed to less expansion by area small businesses. In Wilmington, N.C., a realtor described what he saw as the "first cracks" in the local market—he said that he was spending more time chasing smaller, lower-quality deals.

Tourism: Tourist activity strengthened further in June and July. Bookings for the Fourth of July holiday were much stronger than a year ago; one contact on the Outer Banks of North Carolina credited the well-publicized move of the Cape Hatteras Lighthouse for increased tourist traffic during the holiday. She noted that the move attracted over 250,000 tourists to Cape Hatteras during June and early July. In South Carolina, record-breaking attendance was reported at the annual Spoleto Performing Arts Festival in Charleston, held in late May and June of this year. Looking forward, contacts at District hotels and resorts expected tourist activity to remain strong through the end of the year.

Temporary Employment: Demand for temporary workers has remained high since our last report, and firms reportedly continue to scramble for qualified employees. According to temporary employment agents, technology-based industries still led the pack in the number of contingent workers demanded and many indicated that they have had even more trouble finding skilled workers in recent weeks. Firms continue to rely on a "temp-to-perm" hiring strategy, but not to a noticeably larger degree than a year ago. Wages increased only modestly; one Charlotte, N.C., agent commented that "companies will pay a good wage for a good worker—the problem is I can't find many." Employment agents do not foresee any slowdown in the demand for temporary workers over the next few months, nor do they expect a substantial increase in wages during that period.

Agriculture: Agricultural analysts reported that despite scattered rainfall in recent days, unusually hot, dry conditions persist across most of the District. Recent rains were not sufficient to replenish low topsoil moisture levels in most areas and crop yields will suffer—especially corn and soybeans. In West Virginia, 35 percent of farmers continued to supplement water supplies for livestock, and in Virginia some producers were "chopping" corn to supplement livestock feedings due to the poor condition of hayfields and pastureland.

SIXTH DISTRICT – ATLANTA

Summary: Reports from contacts around the District indicate that moderate growth continues and the outlook is positive. July sales results have been up moderately compared with a year ago, and this trend is expected to continue through year-end. The tourism and hospitality sector continues to post strong numbers. Residential construction slowed recently but remains at strong levels, while commercial construction is slightly ahead of last year at this time. Manufacturing has slowed recently, but contacts remain upbeat about future prospects. Overall loan demand continues to be healthy despite a slowdown in mortgage refinancing. Demand continues to be extremely strong for available workers, but wage pressures remain largely subdued. With only a few exceptions, District contacts report stable prices.

Consumer Spending: According to reports from District retailers, sales results during June were mixed, but improved in July. Most merchants said that sales were up slightly to significantly in July and met or exceeded their expectations, and inventories are balanced. Women's apparel and home-related products have been the strongest sellers in the region, while men's and children's apparel and cosmetics have had mixed results. A regional department store announced that, because of fierce competition, they would be closing their 12 stores in Georgia and their 37 stores in Florida. Looking ahead, most retailers expect third- and fourth-quarter sales will be up slightly from a year ago, and they have not adjusted planned fourth-quarter inventories to deal with potential Y2K problems.

Construction: District builders indicate that single-family home construction growth during the second quarter was flat to slightly up. During July, home construction slowed a bit on a year-over-year basis when compared with June. However, new home sales improved somewhat in July, with the strongest reports coming from Florida. A notable minority of builders and Realtors said that home inventories were low. Several builders complain that a shortage of lots and the continued shortage of key building materials are slowing construction and pushing home prices up. Looking forward, most builders expect construction to be flat during the third quarter, while the outlook among Realtors is more mixed.

Through midyear, the pace of District nonresidential construction is similar to that of a year ago. Construction is slightly ahead of last year in Florida, Georgia and Tennessee, and below year-ago levels in Alabama, Louisiana, and Mississippi. Office, industrial, and retail markets in the region generally remain balanced. The pace of District multifamily construction through the second quarter is ahead of last year; however, permits have declined in Alabama, Georgia, Mississippi and Tennessee.

Manufacturing: Factory output slowed for some manufacturers since the last report, but most contacts are positive about the long-term outlook. Cheap imports and weakness in denim, yarn, and apparel markets have forced the closure of a 100-year-old mill in Georgia and a 400-employee plant in Alabama. The strong housing market, however, is boosting demand for other textiles such as carpet and home furnishings. Other District producers are also said to be benefiting from housing demand. For example, new orders are rising for a plywood producer, production is up for a window manufacturer, and employment is increasing at an appliance producer. Wood pulp, paper, and packaging shipments are reportedly beginning to rebound. Less positively, a large Alabama steel producer has filed for bankruptcy because of competition from foreign imports. Funding problems for the F-22 fighter plane have put about 1,500 workers' jobs in jeopardy at a Georgia plant. Oil company mergers are resulting in further job cuts in Louisiana's petroleum industry.

Tourism and Business Travel: Most reports from the tourism and hospitality sector continue to indicate a favorable picture. Airport traffic, hotel occupancies and future bookings to southwest Florida are at record levels. South American travel to Miami is reportedly recovering, following a slump in the year's first quarter. Tourism in Palm Beach, however, is down a little from last year's record summer. Walt Disney World's "millennium celebration" is expected to attract more visitors to the central Florida theme park. Along the Mississippi Gulf Coast, gaming receipts are at high levels, and casinos continue to expand.

Financial: Loan demand continues to expand at a healthy pace throughout the Sixth District. Consumer and commercial loan demand remain robust. Despite a slowdown in refinancing, overall mortgage demand continues to be healthy, and automobile loan demand is strong. Even as competition for quality loans is becoming more prevalent, overall credit quality and loan standards remain unchanged.

Wages and Prices: Labor markets remain tight in the District, but most contacts report little evidence of accelerating wages. Temporary employment agencies report continued high demand for anyone who can work in information-technology jobs. Contacts in metropolitan areas and resorts cite a continuing shortage of service-industry workers, especially at restaurants and retailers. There are reports of some upward pressure in salaries and wages because of a shortage of health-care professionals in parts of the District.

Most contacts report that prices are stable and are not expected to change much over the next few months. Notable exceptions were increasing prescription drug costs and continued price increases for many building materials, including drywall, brick, framing lumber, and insulation. One Florida contact notes that most firms he deals with believe that they have cut all inefficiencies out of operations and that the time is approaching when they will have no choice but to hike prices.

SEVENTH DISTRICT—CHICAGO

Summary. Conditions in the Seventh District economy in June and July again were characterized by modest expansion and very tight labor markets. Consumer spending remained strong, led by resilient demand for home-related items and light vehicles. Construction activity was again robust, but some realtors and homebuilders lowered their expectations for the coming months. Exceptional motor vehicle production, both light vehicles and heavy trucks, led a robust manufacturing sector, despite some segments continuing to struggle. Increased demand for business loans offset a notable decline in residential refinancing, as overall lending activity remained brisk. Worker shortages continued to hinder some regional firms' expansion plans, and there were a few new reports of intensifying wage pressures. Overall crop conditions were good, but deteriorated in some areas as a result of hot, dry weather. Commodity prices remained low, and a survey of agricultural bankers suggested that farmland values declined in some areas during the second quarter.

Consumer spending. Most retailers indicated that sales in June and July were moderately above last year's results and in line with their expectations. As in our previous reports, sales of items related to the home (furniture, electronics, lawn and garden, etc.) continued at a very strong pace. Most contacts noted, however, that mid-summer sales of many products are typically slow and that "back-to-school" sales beginning in August will better reflect the underlying strength in consumer spending. District auto dealers reported that sales in July slowed somewhat from the torrid pace in May and June, yet showroom traffic remained high and demand strong. One auto dealer noted that bank financing rates had increased noticeably in recent months and expressed surprise that this had not hampered sales to a greater extent. Most retail contacts expect consumer spending to remain strong in the near term, citing tight labor markets and high consumer confidence as contributing factors. Overall retail inventories were reported to be in good shape and there were no new reports of significant discounting or price increases at the retail level.

Construction/real estate. Overall construction activity was robust in June and July, while expectations for the coming months appeared to be slipping. A national report showed existing home sales in the Midwest up significantly in June and realtors in the District indicated that July's sales, while somewhat slower than in June, were very strong and above year-ago levels. A national survey of homebuilders showed a similar pattern in new home sales. The index reflecting sales in the Midwest fell in July from June's very high level, yet was above last July's reading. Both realtors and homebuilders had lowered their expectations since our previous report, with one realtor expressing the general sentiment that the housing market "has been so good, for so long, you just wonder if it can keep up." Commercial construction activity remained strong, very similar to the conditions noted in our last report. Office vacancy rates were again very low, leading to new construction projects in some metro areas. One contact in the Chicago area noted that some real estate professionals were "a little concerned" that the hotel segment was being overbuilt. Shortages of wallboard and labor persisted in the District, which builders cited as hindering some projects.

Manufacturing. Led by exceptional strength in motor vehicles, manufacturing activity remained robust in the District, although some industry segments showed signs of softening. Light vehicle sales nationally retreated slightly in July, from very high levels in June, but remained exceptionally strong and contacts suggested there were no signs of softening demand. Incentive spending was higher than some industry contacts expected even as inventory levels were reported to be in line with sales expectations. Sales of class 8 heavy trucks set records in recent months as cancellation rates decreased and backlogs increased. On the other hand, sales of class 5-7 trucks were headed in the opposite direction, with new orders slowing, cancellations increasing, and inventories building. Orders for construction equipment were reportedly softening and some industry contacts expected sales for 1999 to be flat with last year, if not down slightly. The agricultural equipment sector continued to struggle, with industry sales off about 35 percent from last year. Wallboard producers, noting continued strength in housing, increased prices about 15 percent year-to-date through June, even as new capacity was coming online. Demand for steel was said to be down slightly since our last report and prices remained below year-ago levels, but were recovering somewhat. More generally, purchasing managers throughout the District reported an increase in prices paid in July.

Banking/finance. Lending activity remained brisk in June and July, despite a notable drop-off in residential refinancing activity as mortgage interest rates increased. Business lending continued at very high levels with contacts at District banks describing activity as "booming" and "vigorous...the fastest pace in a decade." One banker suggested that strength in demand for business loans had offset significant competition for those loans, allowing the bank to firm its pricing. Some lenders have been looking at commercial loans with a more discerning eye, with a few noting that chargeoffs on commercial loans had increased modestly in recent months, though not significantly. Overall consumer lending activity remained high, resulting largely from strong sales of homes and light vehicles. Rising mortgage interest rates led to a significant decrease in the number of home refinance loans, but strength in new and existing home sales mitigated the loss of volume. A contact at one large money center bank reported that the wave of refinancing activity earlier in the year left consumers with improved balance sheets, resulting in fewer consumer loan chargeoffs.

Labor markets. Tight labor markets and worker shortages persisted in the District in recent months despite a slight increase in unemployment rates. State employment agency analysts attribute this slight increase to a surge in labor force participation in excess of the rate of employment growth, which remained relatively stable. Manufacturing employment had stabilized after steadily declining through the second half of 1998, and purchasing managers' surveys from across the District suggest that worker demand from the manufacturing sector remained relatively strong in July. There were a few new reports of increased turnover rates as skilled workers were being lured away by higher salaries offered by competitors. Contacts noted that starting wages for recent college graduates with accounting and/or technical skills, as well as some entry-level positions, were up significantly from last year. Another, however, noted slackening demand for technical staff as some Y2K concerns have been resolved. Contacts in many areas indicated that worker shortages continued to hamper business and production expansion plans.

Agriculture. Corn and soybean crop conditions were good, but hot, dry weather in Indiana, Illinois, and southern Iowa reduced soil moisture levels, causing crop condition ratings to decline in the second half of July. The hot weather, however, helped move crop development along more quickly than usual, keeping corn and soybean prices under downward pressure due to the large anticipated fall harvest. Hog prices also remained weak, averaging well below farmers' costs of production. Preliminary results from a survey of agricultural bankers suggested that farmland values during the second quarter declined in Illinois and Iowa, but rose in Indiana, Michigan, and Wisconsin. A majority of these bankers indicated that the pace of farm loan repayments remained below that of a year earlier, while the number of requests for loan extensions and renewals rose.

EIGHTH DISTRICT - ST. LOUIS

Summary

The District economy continues to grow at a brisk pace. Most contacts report growth in sales and demand. Despite continuing difficulties filling some job vacancies, upward wage pressures remain at bay. Housing markets throughout the District are still very strong, with many still on pace for record sales and growth this year. District banks remain very healthy; however, booked loans have declined recently. Despite persistent heat and the lack of adequate rainfall in July, crops remain in mostly good condition across District states.

Manufacturing and Other Business Activity

District contacts, for the most part, continue to report increases in the pace of economic activity, although many are still being hampered somewhat by a lack of available, qualified workers to fill job vacancies. A number of construction projects are delayed because of backlogs in contractors' schedules, caused by shortages of skilled workers and, in many cases, materials (especially drywall). Several contacts in the construction industry have noted that it has become extremely difficult to attract young workers into the trades, which adds to the labor strain. A contact in the trucking industry reports that the lack of available drivers has forced his firm to recruit from overseas. Despite the ongoing shortage of workers in these and many other industries, nominal wage increases remain subdued, averaging between 3 and 3.5 percent for most workers.

UPS and FedEx continue to attract distribution operations to the regions near their hubs. For example, BMW announced that it is building a new parts distribution center in northern Mississippi because of the area's proximity to Memphis. A bit of the silver lining some analysts had anticipated from the recent Boeing layoffs has appeared, as several firms have expressed an interest in locating and expanding in the St. Louis region because of the recent availability of skilled machinists. For instance, an aviation firm chose southern Illinois for its aircraft conversion and maintenance facility, which will initially employ between 300 and 350 workers.

Examples of weakness exist too. For instance, contacts in the poultry-processing industry report an unusually weak season at a time when demand normally soars. Falling feed prices are helping a bit, though. Historically low prices in hog markets, coupled with increased competition from beef and poultry, have led to some slaughterhouse closings. General Electric noted that its current refrigerator production levels are outstripping previously anticipated demand; it plans to permanently lay off about 300 workers.

Real Estate and Construction

Sales of new and existing homes—especially at the high end of the market—remain strong throughout the District. Many real estate agents believe that sales are on pace to set a new record this year. May and June monthly residential building permit growth matched sales; it was up in almost all District metropolitan areas. Compared with a year earlier, year-to-date building permits are also up almost across the board, although the rates of increase have recently moderated somewhat, particularly in parts of Arkansas. A contractor noted, though, that more buyers of mid-priced homes are requesting upgrades—especially in bathrooms and kitchens—that have usually been found only in more expensive homes.

Activity in nonresidential real estate markets appears to have picked up over the past few weeks. Some commercial real estate agents expect continued growth in demand for Class A office space. Industrial markets, especially in the Memphis area, remain strong as demand for warehouse space continues to grow.

Banking and Finance

Total loans outstanding at a sample of large District banks declined 1.5 percent between mid-May and mid-July. Despite thriving real estate markets, this decline was driven entirely by a more than 5 percent drop in the level of real estate loans (the banks' largest loan category), likely the result of higher mortgage rates, a broadening mortgage market in which commercial banks play a dwindling part, and the sale of some real estate loans to the secondary market. The decline also followed on the heels of a more than 4 percent drop in real estate loans two months earlier. Both of the other main categories—consumer loans and commercial and industrial loans—increased during this period. Two months earlier, though, consumer loans had shown no growth. All the while, the level of total deposits at these banks has been declining. Overall, however, contacts report that the banking industry remains extremely healthy.

Agriculture and Natural Resources

Hot and dry conditions persisted across most District states in July. The steady depletion of soil moisture caused an overall decline in the condition of most crops, with pasture conditions generally in worse shape. The extent of the depletion, however, appeared to vary somewhat geographically. Although the lack of adequate rainfall was prevalent in most states, a greater percentage of the major crops (corn, rice, soybeans and cotton) in Arkansas, Kentucky, Mississippi and Tennessee, than in Illinois, Indiana and Missouri, are in good-to-excellent condition. All told, though, the pace of crop development is ahead of its five-year average in most areas.

NINTH DISTRICT--MINNEAPOLIS

The pulse of the Ninth District economy continues strong. With the exception of natural resource-based businesses, most district firms are having a good year. Retail sales are robust; construction, particularly highway building, is healthy; tourism is gaining momentum after a slow, weather-induced start. Prices are generally stable, with a few exceptions. Signs of wage increases are evident as the region's businesses continue to cope with labor shortages.

Construction and Real Estate

Construction continues to provide momentum. In homebuilding, housing units authorized increased in all district states, except Montana, for the three-month period ending in June compared with a year earlier. Contract awards for roads and bridges climbed 8 percent in Minnesota and the Dakotas for June year-to-date, primarily buoyed by increases in federal highway money. “It’s kind of nutty right now,” is how a county board chairman in northwest Wisconsin describes the significant amount of public and private construction planned for the next two years. A major Minneapolis property developer claims that the real estate market will remain healthy, but cautions that certain property types and regions within the area might see higher vacancy rates as new space becomes available. Also supporting future slowing, contract awards for private and public buildings dropped 11 percent in Minnesota and the Dakotas for June year-to-date compared with a year earlier.

Consumer Spending and Tourism

Consumers and tourists continue to provide considerable thrust to the district economy. Consumer confidence is strong in Montana, says a branch bank director. A mall manager in Minneapolis reports recent retail sales are up more than 10 percent compared with a year earlier. Three retail centers in a county near Minneapolis are currently undertaking major expansions.

Most auto dealers in metropolitan areas of western Montana and South Dakota report strong sales, with slower sales in agricultural areas. Some South Dakota dealers describe the past six months as the best they’ve had since the 1980s, according to a representative of an auto dealer association.

Summer tourism has picked up since the Fourth of July after a slow start due to wet weather. The region is anticipating up to a 5 percent year-to-year increase, according to a tourism industry representative. A survey of 80 hotels, lodges and campgrounds in Minnesota revealed that about 75 percent of establishments consider business the same or better than last year and expect continued strength through the rest of the season. Inquiries and visits are up in Montana, says a tourism official.

Manufacturing

Manufacturing in the district remains quite strong, although manufacturers are constrained by lack of qualified workers. Some signs of growth are evident, including expansions at a Minnesota automobile plant, a computer component manufacturer plant in western Wisconsin and a western Minnesota cheese plant. However, Minnesota manufacturing employment remains slightly below year-earlier levels. A southern Minnesota machine manufacturer noted lower factory utilization due to difficulty finding laborers. Many district manufacturers reported productivity improvements in response to labor constraints. However, a Creighton University survey reported soft manufacturing activity in the Dakotas. The St. Cloud (Minnesota) Area Business Outlook Survey revealed a decrease in average manufacturing weekly work hours.

Mining and Energy

Metal-based mining industries continue to slide. Low prices for many metals have depressed mining output. District iron ore production in April is 10 percent below year-earlier levels and iron ore inventories are 10 percent higher than year-earlier levels. A major iron mining company plans to reduce late-1999 production by 600,000 tons. A northern Minnesota taconite mine plans to shut down for the month of November, temporarily laying off 500 full-time employees.

Meanwhile, oil exploration levels have increased from early spring and further gains are expected if oil prices remain at current levels. However, oil exploration activity remains below year-ago levels with only five rigs working in North Dakota and four rigs operating in Montana compared to 14 and 10, respectively, a year ago. In addition, May oil production in North Dakota and Montana was down 4 percent and 5 percent, respectively, from year-earlier levels.

Agriculture

Like mining, agriculture is declining. Due to wet weather, 16 percent of North Dakota's farmland is out of production this year. The USDA reports crop progress for the district is below last year's strong levels, but is about average compared with the past five years.

Not only are growing conditions holding down district production, prices remain low and inventories remain high. The USDA projects corn, soybean and wheat prices to stay low throughout 1999 and into 2000. The USDA reports U. S. June corn stocks up 19 percent, soybean stocks up 43 percent and all wheat stocks up 31 percent from year-earlier levels. In addition, in anticipation of continued low prices, many farmers are building grain storage bins to hold this year's crop.

Employment, Wages and Prices

"Nobody should say they can't find a job," says a manager of a job service center in Duluth, Minnesota. For example, welders and other construction trade workers are in short supply. Moreover, companies continue to expand and seek employees. An electronics warranty company plans to expand in Great Falls, Mont., creating 300 to 500 new jobs. Mergers among headquarters and divisions of major Minneapolis/St. Paul companies are expected to cause layoffs in the coming months. However, with the area's unemployment rate at 2.5 percent, workers in transition are expected to find jobs.

The tight labor market is forcing employers to expand hiring strategies, such as recruiting at job fairs and searching out of state. Summer camps in northern Wisconsin have hired 300 students from foreign countries to fill open positions.

Attracting and retaining employees have pushed up wages. Almost 60 percent of firms surveyed in the St. Cloud Area Business Outlook Survey reported higher levels of employee compensation in June than three months ago, down slightly from 70 percent reported in the March survey. A bus driver shortage in the Minneapolis/St. Paul area may increase transportation costs by double-digits in some school districts due to pay increases for drivers.

Reports of price increases are sparse. Several bank directors say that retailers are holding prices steady or decreasing prices due to increased competition. According to the St. Cloud survey, only 30 percent of responding firms report that prices received in June were higher than in March; 60 percent indicate no change. A Helena branch director says that prices in southwest Montana have remained stable and retailers have felt no pressure to raise prices. There are exceptions, as prices are climbing for gasoline, health care and construction inputs, such as drywall, insulation and lumber.

TENTH DISTRICT - KANSAS CITY

Overview. The district economy remained healthy in June and early July, but growth continued to slow from the brisk rate of last year. The recent boom in construction appeared to subside somewhat, and manufacturing activity slowed slightly from a strong performance in May. Retail activity was flat, although sales were still comfortably higher than a year ago. District farmers faced cash flow concerns as grain prices continued to fall. Labor markets in most of the district remained very tight, with wage pressures present but largely unchanged from previous surveys. Retail prices continued to edge up, as did prices for construction materials. Prices for some manufacturing materials fell.

Retail Sales. Retailers in the district report flat sales in June and early July, at virtually the same high levels registered earlier in the year. Casual clothing sold well, helping to keep overall sales comfortably above year-ago levels. Inventories continued to expand and are expected to rise further, as stores prepare for the back-to-school season. Managers remain optimistic about future sales, especially in urban areas. Automobile sales rebounded after showing some weakness in May, although purchases of passenger cars continued to lag behind purchases of other vehicle types. Dealers' inventory concerns eased somewhat as stronger sales were matched by a steady supply. Vehicle sales in the near future are expected to remain solid.

Manufacturing. Tenth District factory activity slowed slightly but remained much improved compared with the beginning of the year. Plants report a modest decline in capacity utilization in June and early July following consistent increases for several months. Most manufacturing materials remained generally available, with slight increases in lead times for some inputs, such as steel and plastic materials. Purchasing managers continued to express concerns about future material availability. More plants were reducing inventories than in previous surveys, and most plan to continue trimming stock levels.

Housing. Builders report slower construction activity in the district, although the number of housing starts remained higher than a year ago. Expectations for future building activity also weakened. Availability problems continued for many construction materials, including sheetrock, insulation, lumber, and brick. Builders expect that availability problems will persist for several months. Home sales slowed somewhat but remain around year-ago levels, with inventories of unsold homes staying at moderate levels. Mortgage lenders report a significant decline in refinancing activity in June and July. They expect a gradual decline in mortgage demand in coming months, due largely to interest rate uncertainty.

Banking. Bankers report that loans increased and deposits held steady in July, boosting loan-deposit ratios. Loan demand grew most for commercial and industrial loans and residential construction loans. Stronger loan demand was also reported for consumer loans, home equity loans, and commercial real estate loans. On the deposit side, increases in demand deposits and money market deposit accounts were offset by a decrease in large time deposits. Almost all respondent banks increased their prime lending rate last month, and some banks also raised their consumer lending rates. While most banks expect to maintain their prime rate in the near term, a few banks expect to raise their consumer lending rates. Lending standards were generally unchanged.

Energy. District energy activity leveled off in July, as producers remain cautious about oil prices. After posting modest gains for two months in a row, the rig count was virtually unchanged from June to July, at almost 30 percent below year-ago levels. Oil prices stalled in May and June, but rose 12 percent July, pointing to a likely uptick in rig activity in coming months.

Agriculture. The district's winter wheat harvest is almost complete, with production down about 10 percent from a year ago. Heavy rains in southern parts of the district hurt yields and the quality of the crop, but other parts of the district fared somewhat better. The district corn and soybean crops are generally in good condition with above-average yields expected. If realized, the high yields combined with large spring plantings will result in a near-record corn and soybean harvest this fall. Large supplies of wheat, corn, and soybeans have pushed down crop prices significantly, creating cash flow concerns for many district producers. To date, district bankers do not report a significant increase in voluntary farm or equipment sales as a result of low crop prices; nor has there been a sharp drop in rural business conditions. However, most district bankers expect an increase in farm sales next year, which could depress business and consumer confidence in the rural economy.

Wages and Prices. Labor markets remained very tight in most of the district, with continued, but not increasing, evidence of wage pressures. Shortages of construction and retail workers were similar to the recent past, while manufacturers experienced increased difficulties. All types of construction workers were in short supply, with reports of some builders recruiting internationally to obtain skilled tradesmen. Retailers also faced shortages across the board. Manufacturers experienced difficulties finding workers in general, but welders and machinists were particularly hard to find. Overall wage pressures were similar to the previous survey, but respondents continued to note sizable pay increases for positions such as skilled construction tradesmen and IT workers, particularly in Denver, Kansas City, and Omaha. In addition, the use of signing bonuses appears to have increased in the construction sector. Retail prices edged up again in June and are likely to continue edging upward in the near future. Manufacturers report that prices for several materials, including steel and grain, fell in June but are expected to level off soon. Prices of construction materials continued to rise as building activity remained strong, and further increases are expected in coming months.

ELEVENTH DISTRICT--DALLAS

In late June and July, Eleventh District economic activity accelerated slightly. Demand for manufactured goods and cargo transportation services increased. Energy activity increased slightly with more gas drilling and less oil drilling. Demand for business and financial services was steady, and construction and real estate activity was unchanged. Agricultural producers reported generally good growing conditions. Retail sales slowed in July.

Prices. Over the past six weeks, there were more reports of price increases than decreases. Firms reported labor market tightness led to wage increases of 5 to 7 percent in the food industry and 5 to 10 percent for programmers and engineers. Wages of truckers and legal and temporary workers also rose. One food manufacturer said, "There's nobody out there to hire." A decline in applicants was also reported by lumber and paper firms. An ongoing shortage of skilled construction labor caused continued backlogs in new homes orders and higher building costs. Prices of building products—such as lumber products, imported hardwoods, brick and metals—also rose slightly over the past six weeks. Home prices increased at a slower rate, and builders reported that increased construction costs kept margins unchanged from last year. Prices of hydrocarbons—such as oil, natural gas, fuels, ethylene and polyethylene—rose, but margins on gasoline and most petrochemicals slipped. Paper and box prices rose 6 to 10 percent in July, due to decreased supply. Several retailers said selling prices increased slightly in the second quarter. Prices of apparel, cars, and business services were unchanged. Timber prices and air fares continued to fall. Some firms reduced cement prices by as much as 10 percent due to increased competition. Some memory chip prices fell sharply since the last beige book, but were expected to increase in coming months.

Manufacturing. Manufacturing activity increased over the past six weeks. Contacts reported a pickup in chemical sales to Asia and the construction industry. Semiconductor sales to Asia also picked up as retail inventories were depleted. Semiconductor firms reported increased hiring, as overall chip sales rose due to a pickup in final-product sales and in anticipation of strong demand for new products. Sales of fabricated metals were up slightly because of increased demand from the semiconductor industry. Food sales were also up somewhat. Backlogs of brick orders rose to record levels due to continued strong demand from homebuilders. Sales of lumber, paper, primary metals and apparel were steady over the past six weeks. Cement producers reported weaker sales and swelling inventories in July due to wet weather, slightly lower demand from homebuilders and continued weakness in the agricultural and energy industries. Weaker-than-expected gasoline demand in July, rising oil prices and excess inventories put downward pressure on refiner margins.

Services. Demand for business services was steady over the past six weeks. Temporary services firms reported a slight increase in demand. Legal and accounting contacts reported softening demand over the past three months in the real estate, energy and agriculture sectors, but continued strength in mergers and acquisitions, litigation and the technology sector. Demand for trucking services strengthened and demand for rail cargo services remained steady in the last six weeks. Trucking contacts expected continued increases in cargo volumes.

Retail Sales. Some retailers reported that sales slowed significantly in July after growing at a hectic pace in May and June. Overall Texas sales were reported as slightly weaker than national sales, which is typically not the case. Although inventories were depleted as a result of two months of heavy sales, contacts believed that the sales drop was not just related to lower inventories. Customers may have postponed some purchases until the Texas retail tax holiday weekend in August. Nevertheless, "anything household-related has flown off the shelves." Contacts remained cautiously optimistic about the outlook, reserving their judgement until they see back-to-school sales. Auto sales remained steady over the past six weeks at levels above last year, and "higher than anyone had expected."

Financial Services. Contacts reported continued healthy credit quality at district banks over the past six weeks, but reported some minor concern of worsening credit quality in larger banks at the national level. Loan demand was steady, with "near record" auto and consumer type lending, competitive commercial lending, weak agricultural lending, and a tapering off in real estate lending. Most contacts report Y2K readiness and expect no problems this winter.

Construction and Real Estate. Construction activity stayed hectic but slightly fewer homes and offices were started. Real estate activity was steady over the past six weeks, with continued brisk used home sales. Despite increased office absorption over the past three months, completions of new buildings increased vacancy rates in Dallas. New home sales softened somewhat but remained at very high levels. Industrial space absorption kept pace with supply, but some contacts expected slight declines in occupancy rates by year-end as new projects are completed.

Energy. Although the rig count increased in recent months, contacts reported a much smaller increase in the demand for oil services and a continuation of layoffs. Increases in the rig count have come from gas-directed, low-risk, and inexpensive drilling. Despite rising oil prices, spending for capital intensive projects—such as offshore or foreign drilling—continued to decline slowly because the industry lacks confidence that prices will be sustained.

Agriculture. Agricultural producers benefitted from recent disaster payments, which enabled some to pay off debts resulting from 1998 losses. Nonetheless, low commodity prices are challenging many producers, and they are having difficulty earning a profit. Crop and livestock conditions were generally good in most areas. Rainfall increased range growth and greening. Grasshoppers were a problem to both crops and pastures in many areas.

TWELFTH DISTRICT SAN FRANCISCO

Summary

Reports from contacts indicated strong economic conditions in the Twelfth District during the most recent survey period. Retailers reported solid sales growth, while service providers in the District noted a pickup in growth above an already rapid pace. Manufacturing activity picked up in much of the District, although import competition continued to temper growth in some sectors. Conditions among many agricultural producers in the District deteriorated in recent weeks, as poor weather, low prices, and weak demand challenged profitability. Strong residential and commercial real estate demand continued to fuel construction activity in much of the District, reportedly producing material and labor shortages in several states. Financial conditions remained favorable throughout the District, and competition for quality borrowers intensified.

Business Sentiment

District respondents expect continued strong performance in the U.S. economy, with regional growth outpacing the national rate. Nearly all respondents expect national GDP growth to equal or exceed its long-run average pace, leaving the national rate of unemployment at or below its current level. Respondents remained concerned about inflation; about one-half of District contacts expect inflation to increase in coming quarters. Nearly all respondents expect economic growth in their region to outpace growth in the national economy over the next year. Respondents were particularly optimistic about the strength of business investment and consumer spending in their areas. In contrast to earlier in the year, more than one-half of District respondents expect the region's foreign trade balance to improve in coming quarters.

Retail Trade and Services

Retailers in most District states reported solid sales growth in recent weeks. The strongest reports were from California and the Intermountain states, where rapid sales of apparel, food, and automobiles were noted. Contacts in the Pacific Northwest reported slower growth in retail sales than in previous weeks, largely due to flat sales of food and apparel. Overall, District retailers reported adequate inventory levels and few problems obtaining merchandise from suppliers. Retailers throughout the District noted that stiff competition and falling import prices have kept retail prices down, despite healthy consumer demand and rising labor and occupancy costs.

Service industry respondents in most District states continued to report robust growth. In California and the Pacific Northwest, sales of telecommunications and media services remained high, boosted by surging demand for internet and cable access. Respondents from California and Nevada reported brisk demand for tourism-related services; in contrast, Hawaii's tourism sector remained weak in recent months, tempered by further declines in East Asian visitor traffic. Strong import growth and a pickup in exports kept port traffic at high levels in recent weeks, reportedly pushing shipping and container prices up throughout the District. High gasoline prices reportedly have affected prices for ground freight; one contact reported that some transportation vendors have begun to index shipping contracts to gasoline prices.

Manufacturing

Reports on District manufacturing activity generally were positive, although some sectors remained weak. Contacts noted that modest increases in East Asian demand, particularly from South Korea, have boosted sales among manufacturers of high-tech products, particularly computers and telecommunications equipment. Producers of lumber and wood products also reported robust demand, fueled by a strong domestic construction market and a resurgence of export demand. In California, some apparel manufacturers noted that solid demand for finished goods and low input prices for imported fabrics have improved conditions in their industry. On the down side, commercial aircraft orders remained at low levels. Manufacturers of steel, steel products, and machine tools also reported weak conditions, primarily owing to intense competition from low-priced imports.

Agriculture and Resource-related Industries

District agricultural producers reported mixed conditions in recent weeks, with additional deterioration in some sectors. Weak global demand for U.S. products, low prices, and poor weather have combined to limit the profitability of farmers throughout the District. Growers of grain and potatoes have been particularly hard hit. In contrast, conditions for ranchers, particularly of cattle, reportedly improved in recent weeks, boosted by increased demand for beef and falling feed grain prices. Despite improved conditions, contacts noted that profitability in the cattle industry remains below its 10-year average, inducing some small ranchers to exit the market. Respondents throughout the District also reported significant difficulties obtaining seasonal agricultural workers. District energy producers reported improved conditions in recent weeks.

Real Estate and Construction

District construction activity remained at high levels in most areas, with robust demand for non-residential real estate largely offsetting slowing in many housing markets. Respondents in many areas of the District outside of California noted declines in new housing starts and slowing sales of new and existing homes. However, commercial real estate and construction activity in these areas remains strong and has kept demand high for contractors, subcontractors, and materials. Respondents from California, Oregon, Washington, and Idaho noted that shortages of building materials, such as drywall and lumber, and skilled labor have begun to delay completion deadlines and increase project costs in some cases.

Financial Institutions

Twelfth District banking conditions remained favorable in recent weeks. Respondents reported that bank capital and liquidity were ample, and competition for loans remained intense, with quality borrowers receiving excellent terms and rates. Although competition has kept margins thin, contacts reported that year-to-date profits have met expectations. District contacts indicated that overall consumer and commercial credit quality remained stable in recent weeks, although a slight deterioration in the quality of automobile loans was noted.