

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

January 1986

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SUMMARY*

This month's commentaries on regional economic activity suggest that the economy is growing at a moderate pace on balance. Several Banks, including Philadelphia, Richmond, Minneapolis, Kansas City, and San Francisco, pointed to signs of improving business activity in their respective Districts. Most other Banks reported little change. Dallas reported that its economy remained sluggish, and St. Louis noted a continuation of the conflicting signals reported earlier for its region. Chicago pointed to continued weakness in its District and indicated that it expected business activity there to lag the national economy in 1986.

The economic picture is uneven across sectors. Consumer spending appears to have been moderately strong during the Christmas season in most regions, although Chicago reported that sales were disappointing. Construction activity was also reported to be relatively strong, especially in the residential sector. Manufacturing activity, however, is mixed, ranging from a boom in military electronics in the San Francisco District to activity that remains in the "doldrums" in the Cleveland District. Elsewhere, several reports noted continuing problems in agriculture, including declining livestock prices (Minneapolis and Dallas), rising delinquencies on farm loans (St. Louis), low orange prices (Atlanta), and low tobacco prices (Richmond). Several pockets of strength in the agricultural sector were mentioned, however, including poultry, almonds, and winegrapes.

CONSUMER SPENDING

Much of the comment on consumer spending focused on sales during the Christmas season. Most of the reports indicated satisfactory sales despite the shorter-than-normal selling period between Thanksgiving and Christmas.

*Prepared at the Federal Reserve Bank of Richmond.

Sales were 5 to 10 percent higher than last year in the New York District. They were up 3 to 7 percent in the Philadelphia District, and were described as relatively strong in the Kansas City District, above expectations in the Dallas District, and either level or up moderately in the Boston, Atlanta, Chicago, St. Louis, and Cleveland Districts. Retail inventories appear to be under good control for the most part; they were variously described as relatively low, satisfactory, or well-balanced. Profits of retail merchants were reported to be well above the year-ago level in most districts, due to reduced price competition this Christmas. St. Louis, however, reported that profits were about equal to 1984 levels.

Automobile sales have apparently responded to the latest round of interest rate incentive programs. Cleveland, for example, noted that sales in early January were up as much as 30 percent from year-ago levels. Dallas, however, reported that sales have recently weakened and that inventories of domestic cars were excessive.

There were mixed views of the outlook for consumer spending. While sales are generally expected to increase, some of the reports suggest the increase may be modest in some regions. For example, Kansas City reported that sales are expected to increase only slightly, and Philadelphia indicated that most retailers expect flat sales in the first half.

MANUFACTURING

Manufacturing shipments and orders, on average, appear to be growing at a slow rate, while manufacturing employment continues to decline. Conditions vary widely, however, across industries and regions. Philadelphia noted that orders and shipments are up in its District, but that employment is steady. Boston reported that orders are flat, or increasing modestly, while

employment is being cut by attrition. Cleveland indicated that employment had fallen substantially at more than half of the establishments it had surveyed.

Atlanta and San Francisco reported that defense spending had stimulated industrial activity in their Districts, particularly in the electronic equipment and shipbuilding industries. Richmond and Atlanta reported that activity in the textile industry, hit hard in recent months by imports, had recently stabilized, albeit at a low level. San Francisco and Dallas stated that the output of lumber and wood products in their areas had continued to decline.

Several Banks noted little tangible response to the recent decline in the foreign exchange value of the dollar. Richmond, however, indicated that several District manufacturers had recently reported renewed contacts with former customers. Also, Boston reported that sales to European buyers had picked up quite markedly in the second half of 1985 due, at least in part, to the dollar's decline.

MINING

Dallas reported that the drilling rig count was at its lowest level since 1976, and that the seismic crew count was continuing to fall. Minneapolis also noted declining oil and gas activity but mentioned that a copper mine was reopening. San Francisco indicated that mining activity for metals such as copper remained depressed, but that gold and silver mining were expanding.

CONSTRUCTION AND REAL ESTATE

Seven districts reported moderate to strong increases in residential building activity. Dallas, however, painted a bleak picture of construction activity in its District. It indicated that the value of both residential and nonresidential construction contracts had fallen in each of the last three

months. Atlanta reported that office construction had outpaced leasing recently, and Cleveland reported concern that speculative construction of new office space was excessive in some midwestern cities.

AGRICULTURE

Several Banks mentioned low farm prices and the resulting low farm incomes. Richmond reported low tobacco prices, Atlanta noted low orange prices, and Minneapolis and Dallas found falling livestock prices. Dallas also reported a continuing decline in foreign demand for cotton, and San Francisco noted generally weak farm prices.

The reports on agriculture were not uniformly bleak, however. Richmond indicated that the demand for poultry was strong, and San Francisco found that the lower dollar had aided producers of almonds and winegrapes. Chicago and Minneapolis stated that recent increases in some farm commodity prices were a positive factor. Also, Kansas City reported that excellent crop yields and higher livestock prices had produced a better than expected farm loan situation.

BANKING AND FINANCE

Several Banks reported that both household and business loan demand were strong. Kansas City, however, indicated that loan demand in its District was flat, and Dallas noted that both consumer and business demand were below the year ago level. Only two Banks mentioned the removal of minimum balance requirements on Super-NOW accounts, and both reported that the removal had not yet produced any significant change in deposit pricing policies in their Districts.

FIRST DISTRICT-BOSTON

The First District economy held steady through the end of 1985. Retailers report a generally satisfactory holiday selling season with fewer price markdowns and higher profits than a year earlier. Inventories are in reasonably good shape and merchants are optimistic about 1986. Some manufacturers are seeing modest improvements in orders, others report that orders remain slow; most of those contacted expect 1986 to be a better year for sales and earnings than 1985, but still not particularly good. Banks in the District continue to perform well.

Retail

New England retailers report level or modestly increased sales during the holiday period. A week shorter selling period between Thanksgiving and Christmas contributed to weak November results, but December sales at several stores were substantially above 1984. For the fiscal year ending in January 1986, most of those contacted expect to attain double digit sales growth; while below the previous year's increases, these results are not at all disappointing when retailers compare results with affiliates in other regions.

Inventories are generally close to planned levels. Contacts cited this as one reason for a less "promotional" Christmas: having learned from last year, they anticipated overall demand more conservatively (and more accurately) this year. With lower inventory carrying costs and fewer markdowns, profits were stronger this season. Some individual product lines, of course, performed better or worse than expected. Video cassette

recorders, televisions, tapes and records were widely cited as strong sellers, while reports on toys were mixed.

Projections for 1986 are upbeat. Merchants expect the coming year to be as good as or better than 1985. A recent survey of analysts cited New England's low unemployment rate and high per capita income as reasons for the region's retailers to continue to outperform their counterparts in the rest of the country.

Manufacturing

First District manufacturers report that recent orders have been fairly flat or increasing modestly. Several respondents commented that the commercial aircraft business is improving, albeit slowly. However, sales to the auto companies, which were very strong in 1985, are expected to weaken in 1986. Sales to the farm equipment and machine tool industries remain depressed. High tech contacts have seen slight increases in orders for some products, but the semiconductor business continues to be very slow.

Several of the firms contacted have been reducing employment for some time and are continuing to do so. However, these staff reductions are occurring through attrition rather than layoffs, as was the case in earlier months.

Respondents plan to invest as much or more in 1986 as they did in 1985. The importance of keeping abreast of technology and the need to develop new products were cited as motivations for capital spending. Several contacts mentioned new product introductions as critical to sales increases expected in 1986.

According to several firms, sales in Europe picked up quite markedly in the second half of 1985. This improvement is attributed, at least in part, to the decline in the value of the dollar from the highs of last spring. For high tech producers, sales in the Far East were strong throughout 1985 and remain vigorous.

A regional business magazine recently surveyed securities analysts regarding the prospects for major New England firms in 1986. In general, the analysts expect substantial improvements in the sales and earnings of firms in the traditional metals and machinery industries. For high technology companies as well, 1986 is expected to be a better year than 1985, but earnings prospects vary considerably from one firm to another. According to the analysts, the outlook is more promising for computer companies than for firms involved in the semiconductor business.

Banking

Banks in the First District enjoyed strong earnings in 1985, with a couple of large institutions reporting fourth quarter earnings that surpassed the expectations of security analysts. According to a recent survey of analysts, the growth in bank earnings will be more moderate in 1986.

SECOND DISTRICT--NEW YORK

Almost all sectors of the Second District economy experienced modest gains since the last report. Consumer spending during the Christmas season met most retailers' conservative expectations and inventories were generally at low levels going into the new year. Residential construction has continued strong, in part because of mild weather. In addition, the long-awaited pick-up in office leasing activity appears to have started in northern New Jersey. In contrast, reports are mixed about the strength of current business activity. Nonetheless, the outlook for early 1986 is generally viewed favorably. On the financial side, small District banks report a sharp rise in business loan demand.

Consumer Spending

Consumer spending during the 1985 Christmas season was 5 to 10 percent above last year's disappointing level, and most stores had sales close to plan. New Jersey merchants posted larger than projected gains, while New York City retailers generally experienced modest growth in line with expectations. However, stores in western New York tended to report increases somewhat below plan. Severe snowstorms may have inhibited less hardy shoppers, but some store officials also mentioned the continued weakness in that area's economy. For the most part, department stores fared better than discount houses and low-priced stores. The high level of consumer debt was cited as a deterrent by stores catering to blue-collar and lower-middle income shoppers.

In general, retailers avoided the inventory problems of last year that had necessitated substantial price-cutting to reduce stocks.

Most merchants entered this holiday season with much lower inventories than a year earlier and maintained stocks close to planned levels throughout the period. Because they were able to stick to planned promotions and pricing policies, they anticipate higher profits than last year.

Construction and Real Estate

Residential construction remains strong in the District, and respondents found no evidence in their areas of the sharp drop-off in November housing starts reported for the northeast. In the Syracuse area, for example, November starts were virtually unchanged from a year earlier, and starts through the first 11 months of 1985 equaled the full-year record set there in 1978. Due in part to mild weather, home builders in various parts of the District began the new year at a good pace. Most now expect activity in 1986 to equal or surpass 1985, at least through late summer. However, they said that rising interest rates or unfavorable tax legislation could change this scenario.

While office market conditions were generally stable, in northern New Jersey increased leasing activity and a slowing of new projects have taken some of the slack out of the market. In New York City, additional financial firms are expanding outside Manhattan. Citicorp proposed construction of an office complex in Queens that would be the largest ever built in the outer boroughs. At the same time, a second financial services firm has announced plans to locate some of its operations in an area now under development in Brooklyn.

Business Activity

Economic activity in the Second District showed no clear direction in recent weeks. While a much higher percentage of Rochester purchasing managers reported improved conditions in December, the proportion in Buffalo declined. Inventories remain under control in both

areas, though, and the near-term outlook is generally described as favorable.

Very few industrial developments of major significance have been announced recently. Of considerable concern in the Rochester area, however, is the likely impact of a recent court ruling that Eastman Kodak must terminate its instant photography business because of patent infringements. At the time of the ruling Kodak employed 800 full-time workers in that operation. Also, Avon announced cutbacks of almost 500 workers in the New York metropolitan area. On a more positive note, Piedmont Aviation plans to center its northeastern operations in the upstate New York communities of Utica and Syracuse. In the Buffalo area, a group of local investors recently completed the purchase of a metal-working firm, preserving almost 900 jobs.

The unemployment picture in the District remains relatively good. December unemployment rates were 6.3% in New York State and 5.8% in New Jersey, down slightly from November. For 1985 as a whole, unemployment in New York State was 6.5% and in New Jersey 5.7%, rates below the national average. These were also the lowest levels since the mid-1970's.

Financial Developments

Business loan demand rose sharply during November and December at small Second District banks (and at commercial banks nationwide). Explanations for the increase varied. One bank suggested that it was seasonal borrowing to meet end-of-year business needs, with demand by retailers particularly strong. Other banks indicated that loan demand was not limited to any particular type of borrower or single purpose. In fact, an upstate bank noted that the large volume of loan requests was continuing into 1986, although it thought that the strong demand would not persist.

THIRD DISTRICT - PHILADELPHIA

Economic conditions in the Third District in January are generally improving. A pickup in manufacturing activity that began last fall is continuing, although factory employment has not benefited from the recent gains. Retail sales for the holiday shopping season showed the expected 3-7 percent improvement over 1984, and profit margins improved as well. According to loan officers at large Third District banks, consumer lending is strong and commercial loan demand is rising after a flat second half in 1985.

Expectations for the first half of 1986 vary. Manufacturers have mostly positive views on overall business conditions; however, they expect employment to be stagnant or even to edge downward in coming months. Retailers forecast a lackluster first half as consumers work off debt. Bankers look for continued economic growth in the region. They expect business loan demand to be strong early in the year and to rise further in the second half.

MANUFACTURING

Industrial activity in the Third District is expanding, according to the latest Business Outlook Survey. Thirty-seven percent of the manufacturers replying to the January survey say they have stepped up operations while only 11 percent say their business is off. Manufacturers of both durable and nondurable goods indicate improvement.

Third District manufacturers report gains in new orders and shipments, but note that employment is only holding steady. Backlogs of unfilled orders are also unchanged. Prices of most industrial goods in the region remain stable.

Three-fourths of the manufacturers surveyed say neither input costs nor output prices have changed this month.

Manufacturers are generally optimistic about the first half of 1986, according to the survey. Half of the respondents predict continued growth, and project gains in both new orders and shipments; one-third plan to increase capital expenditures. Prospects for improvement in factory employment remain poor, however; based on responses to the January survey, some workforce cuts are likely to be made over the next six months.

RETAIL

Third District retailers report that the dollar volume of sales during the Christmas season ran 3-7 percent higher than in the 1984 season; this improvement should hold up overall performance for their fiscal fourth quarter, which ends on January 31, 1986. Year-to-year increases above this average were achieved by specialty stores selling apparel, toys, and consumer electronics, and by department stores emphasizing these product lines. Appliances and other hard-goods were slow sellers due to seasonal factors and a late-December surge in auto sales, according to retailers. Discounts and promotional expenses have been in line with plans, and fourth quarter profit margins are reported to be better than a year ago.

Most Third District retailers contacted in January expect a flat first half in 1986. They believe that debt service requirements will result in a cash drain on households that will adversely affect consumer spending until spring. As evidence of consumer retrenchment, they cite the lower than usual ratio of credit-to-total sales in December.

FINANCE

Total loans outstanding at large Third District banks in December were 13 percent higher than a year earlier. Despite a pickup as the year ended, loan

demand was generally weak in the second half. Consumer loan demand remains relatively healthy, although it too was weaker in the fourth quarter than it had been earlier in the year. Credit card outstandings posted strong gains, with other consumer installment lending growing less due to competition from auto manufacturers' low rate programs.

Commercial and industrial loan volume in December 1985 was about 12 percent higher than the level of December 1984, although virtually all of that growth came in the first half of the year. Third District bankers say demand for business loans is picking up, however, and will probably grow at a 10 percent annual rate during the first half of 1986, possibly faster later in the year. Middle market companies -- major commercial customers at Third District banks -- are benefiting from good economic conditions in the region, and bankers note improved balance sheets among firms applying for credit.

Local bank economists predict that the pace of economic growth will accelerate during 1986. They foresee some easing of credit demand as manufacturers and retailers work down inventories during the next few months and federal spending is reduced. Under these conditions, the consensus outlook for interest rates is stability for the first quarter of the year and a slight rise beginning by the third quarter.

FOURTH DISTRICT - CLEVELAND

Summary.

This District's economy is growing slowly despite weakness in manufacturing. Unemployment is high but falling. Holiday retail sales were up moderately from a year ago, and early January new car sales have responded well to sales incentives. Manufacturing remains in the doldrums, with new orders, backlogs, and employment falling, and manufacturers still see little response to dollar depreciation. Housing activity remains strong. Bank loans outstanding rose significantly in the last month.

Retail Sales.

Despite fewer than usual shopping days, holiday season retail sales in the District were up moderately from year-ago sales. A sample of three large general merchandise chains report nominal December sales increases of roughly 4-6 percent from year-ago levels, slightly more than experienced at the national level. Department store sales in the District were particularly strong in the apparel and home improvement categories. None of the retailers contacted express concern over current inventory positions, although many express uncertainty over future sales prospects.

Area new-car dealers report strong sales following the typical holiday sales decline. Most auto dealers report the early January sales gains, in some cases as much as 30 percent above year-ago levels, are a consequence of the nationally sponsored interest-rate incentive programs. However, domestic new-car dealers have also noted a moderate improvement in nonqualifying sales categories, such as luxury new-car models. Few new-car

dealers expect incentive-induced sales gains to last. Local new-car inventories increased in late-December and early-January, but area dealers note that this is typical as they prepare for the anticipated Spring sales increases.

Labor Market Conditions.

Ohio's labor market showed some improvement in the fourth quarter of 1985 as the seasonally adjusted unemployment rate fell from 9.4% in September to 8.3% in December. Hiring expectations for the entire Midwest show a slight decline for the first quarter of 1986 compared to the initial quarters of 1985 and 1984.

Manufacturing.

Manufacturing activity in this District remains in the doldrums. Most firms report manufacturing output was unchanged, and those reporting increases are matched by an equal number reporting production decreases. Employment is falling at substantially more than half of the manufacturing firms surveyed. Manufacturers report new orders and order backlogs have fallen for three consecutive months. Despite the decline in orders and backlogs, a majority of firms report they expect 1986:IQ to be better for their companies than 1985:IVQ. Raw materials inventories fell sharply at yearend, and although some respondents say tax considerations contributed to the decline, inventories have been on a downtrend for several months. Finished goods inventories also continued to decline, falling more sharply at this yearend than at other recent yearends. Manufacturers report prices paid for commodities are falling but prices paid for equipment and services are rising.

There is still very little indication of response to dollar depreciation. Of eight major manufacturing firms that export and/or compete against imports, none report having been able to raise their own prices in response to dollar depreciation, only two report any increase in orders or sales, and the remaining six report having no additional inquiries.

Most steel producers continue to face weak prices and stiff competition as imports exceed levels envisioned by the import control program. Major producers have pruned their operations but more surgery may be needed unless price increases are obtained. Nevertheless, some segments of the industry, such as flat rolled steel used by the auto industry, and specialty steel, are doing well. A steel industry analyst expects domestic steel consumption to fall slightly in 1986, offsetting an expected small decline in imports and leaving domestic steel shipments unchanged.

Housing.

Realtors, builders, and mortgage lenders in this District report continued strength in their businesses. Contacts report record profits in 1985, and expect 1986 profits to be equal or better.

Mortgage lending in the District remains strong, although it has softened in recent weeks because secondary market rates have climbed 65-70 basis points. One major mortgage lender's 1985 mortgage volume was up 50% on a year-to-year basis. Home loan refinancings represented 50% of their loan activity in December. The firm expects a 25% increase in its mortgage loan applications in 1986.

Realtors' transactions volume rose 10% above 1984 levels, bringing record profits in 1985. One major realtor expects another profit record in

1986. Although his new listings are showing signs of slowing, he plans to increase staff 10% in 1986.

A major builder in the District reports record 1985 earnings, despite a small drop in orders. This builder reports a recent surge in traffic, with fewer lookers and more serious buyers. There is little speculative house building, and pre-selling of homes has become a common practice among builders.

Construction.

A major real estate developer reports that speculative construction of office space seems to be excessive in some midwestern cities. He attributes the excess to the easy availability of construction loans and is concerned that in six to twelve months the developers may find too few tenants and no long-term financing.

Commercial Banking.

Loan demand at District banks is picking up. Total loans outstanding at large banks rose significantly over the past month, but much of the increase was due to seasonal factors. Gains in business and consumer installment loans more than offset declines in real estate loans. Although consumer installment lending remains quite strong it has been increasing at a decreasing rate. Contacts expect consumer lending to continue to expand at a double-digit but slower pace. Contacts also expect business loan demand to improve in the first quarter, as more firms begin to rebuild inventories.

FIFTH DISTRICT - RICHMOND**Overview**

Overall economic conditions in the Fifth District remain strong, although the average conceals substantial differences among the sectors of the economy and differences among the states within the District. Consumer spending during the Christmas season was generally satisfactory, with further gains expected in 1986. Manufacturing compares favorably with mid-1985. The agricultural outlook, however, remains poor.

Consumer Spending

Consumer spending remained strong in most areas of the District. Sales during the Christmas season were characterized as satisfactory or acceptable by several retailers. Those retailers noted that volume increases were moderate when compared to year ago figures. Retail profits were reported strong, however, due to much less price promotion in 1985. Inventories at the beginning of the year were reported to be moderate, due in part to restraint in placing orders earlier in 1985.

Automobile sales appear to be strong in many areas. It is difficult to determine the extent to which that strength is due to national incentive programs that lower buyers' contract interest rates.

The outlook for early 1986 is positive, with employment growth in certain areas leading to predictions of robust consumer spending. Some pickup has been noted in particular areas, such as furniture and home furnishings.

Manufacturing

Despite the recent decline in the foreign exchange value of the dollar, many manufacturers in the Fifth District continue to be very concerned about foreign competition. Textile manufacturers, who have reduced production,

capacity, and employment over the last eighteen months, now report some room for optimism in the short-term outlook, with orders not weakening any further and inventories declining. Certain markets for textiles, such as carpets and home furnishings, were reported looking particularly attractive; others, such as apparel, were holding steady.

Several manufacturers reported improved morale due to recent declines in the dollar. Reports of renewed contact with former customers were received from several producers. Most of the reports of higher morale, however, also indicated that the lower dollar has not yet led to higher sales, orders, or production. Reports from manufacturers generally noted improved conditions relative to earlier this year.

Construction

Survey participants reported that commercial real estate vacancies in metropolitan areas of the District were generally not above average, based on the last decade's experience. Several did report unusually low rents for particular projects, however. Respondents reported moderate to strong single-family house sales in almost all areas; the single exception was the Charleston, West Virginia area, in which weak sales and a large inventory of unsold homes were reported. Also in that area, office buildings were reported to have a vacancy rate of about 20 percent.

Financial Institutions

The removal of minimum deposit requirements has not had dramatic effects in this District. Changes are reported to have occurred at few institutions, and marketing activities have been low key and scattered. Concern has been expressed over high levels of consumer debt, with delinquencies especially apparent in credit card operations.

Agriculture

Farm income in the District in 1985 was dampened by low crop prices, particularly for tobacco. Although production expenses declined, net incomes fell substantially. The outlook, according to state agricultural officials, is for additional declines in farm income in 1986. In contrast to other products, poultry production and prices have been robust, and a good 1986 is projected. Also, growing retail demand in recent months was noted for pork products.

SIXTH DISTRICT - ATLANTA

The Southeast economy firmed up early this year, with strength in Georgia and Florida more than offsetting a stagnating Louisiana economy. District unemployment leveled off in October and November, partly due to late-year stability among textile and apparel jobs. Advances in single-family housing, industrial real estate development, and tourism bolstered the regional economy, while commercial construction imbalances and the farm sector weakened it. Slumping auto sales detracted from otherwise good consumer buying. Bank loan growth continued to slow.

Employment and Industry. November's unemployment rate remained unchanged from October at 7.3 percent, with four of the six District states registering rates below those of a year ago. Louisiana's jobless rate has leveled off near 11 percent, the highest in the Southeast. At the other extreme was Florida's rate of 5.2 percent. Although the region's textile and apparel industry has lost 15,400 jobs in the last year, employment levels have recently stabilized. Tennessee furniture makers are keeping inventories lean but are hoping that the weakening dollar will reverse a rising tide of imports. Imported lumber has captured 49 percent of the market in Georgia, 56 percent in Florida, and 10 percent in Alabama, according to industry sources. More positively, new defense contracts for ship construction are increasing employment rolls in Louisiana and Alabama shipyards. In Florida, a backlog of defense electronics orders is expected to stimulate growth in the sector in spite of anticipated defense spending cuts. The ambitious schedule of the space shuttle program (15 launches in 1986) will keep surrounding support industries on Florida's space coast busy throughout the year.

Consumer Spending. District merchants reported flat-to-moderate sales gains for Christmas and the first ten days of January, while year-end auto sales slumped. Regional sales growth was strongest in Atlanta, Birmingham, the central and southern

parts of Florida, and western Tennessee, while much of the region's weakness was in Louisiana and Mississippi. Most merchants posted higher profit margins in 1985 because inventory levels were better managed and increased price promotions boosted sales. Year-over-year car sales in the Southeast dropped in November and December after rising by 11 percent in both the region and the United States in the first ten months of 1985.

Construction. Single-family residential and industrial activity improved, while other southeastern real estate sectors are flat or show current weakness. Atlanta and Tampa home sales in early January are reported to be stronger than early last year. Atlanta buyer traffic, an important indicator of near-future sales, is high for January. Following heavy declines, Atlanta's multi-family building permits increased over 1984 in September, October, and November as builders rushed to acquire industrial development bond financing before year-end. In Jackson, apartment building plans are extremely lean, although absorption is good, causing rents to rise. In New Orleans, apartment vacancy rates are approaching 25 percent, and rents have declined by over 10 percent since last year. South Florida condominium sales are weak, prices are falling, and repossessions are accelerating, but, in central Florida, condo markets are prospering on demand from middle income families.

Office construction continues to outpace leasing, even though incentives are liberally employed in most regional markets. Commercial developers cite uncertainty about future tax law changes as discouraging many investors. Rising vacancy rates are applying downward rent pressure in both Miami and New Orleans. But Atlanta real estate agents view the office market as strong in spite of its 16 percent vacancy figure. Retail construction is described as tentative in Orlando and Tampa, as new space is accumulating and leasing is sluggish. The Tampa and Nashville industrial markets seem set for expansion due to low vacancy rates and growing industrial bases locally.

Financial Services. Total lending activity at large District commercial banks continued to grow, albeit at a slowing rate, throughout 1985. Southeastern commercial bank stock prices took a roller coaster ride last year but largely turned up in Alabama, Florida, and Mississippi in the fourth quarter. Regional thrifts report increased mortgage sales in the secondary market. Louisiana's sagging economy continues to be reflected in its weakening financial services industry. For Louisiana thrifts, regulatory net worth declined by 32 percent in the third quarter of 1985.

Tourism. Last year ended on a fairly strong note for the southeastern tourism industry, and prospects for 1986 are deemed bright by those contacted. Auto travel rose in December in Alabama and Florida after falling in four of the six District states in November. Traffic was up at most regional airports in November, but advance international bookings are not as strong as earlier. Hoteliers in southeastern convention cities report strong advance reservations. However, New Orleans contacts foresee some tapering off by March. Southeastern vacation travel in the first quarter, limited largely to Florida, is expected to grow despite a mixed performance at the end of 1985.

Agriculture. Moderate price increases are occurring for most District crops as supply pressures from harvest season surpluses recede somewhat. But the gains are not sufficient to substantially improve farm income prospects. Animal product industries continue to benefit from low feed costs. Orange prices, high in recent years because of freeze-reduced crops, have fallen substantially in past months as a result of large inventories of processed products, ample imports from Brazil, and prospects for increased Florida production. Growers whose freeze-damaged groves are producing only partial crops face especially severe income reductions.

SEVENTH DISTRICT--CHICAGO

Summary. Analysts in the District generally expect further moderate economic expansion, nationally, in 1986. Our information on District conditions suggests that this region will continue to trail the U.S. Auto and light truck output will remain strong early in 1986. Heavy truck sales and production have declined. Steel production continues weak overall, but may be helped by tighter restraints on imports. Weak demand has persisted for most types of mechanical capital goods produced in the District. Construction, residential and nonresidential, continues vigorous in the District relative to recent years, but well below good levels of the 1970s. Backlogs will support nonresidential building activity near recent levels well into 1986. Consumer spending for general merchandise, through early January, is viewed as disappointing. Although the District's agricultural situation remains bleak, farm commodity prices have risen in recent months from low levels, federal farm income and price support programs have been extended, and the rate of decline in land values has slowed.

Outlook for the District. Recovery in economic activity in the District has generally trailed the U.S. over the past 3 years. This pattern appears likely to continue in 1986. The star performer in the District, since the end of recession in 1982, has been motor vehicles, but further expansion in this sector in 1986, if any, probably will be small. Surveys suggest that investment spending for capital goods produced in the District will be sluggish in 1986. Steel production, heavily concentrated here, may benefit somewhat if import restraints are tightened.

Motor Vehicles. Auto production plans for early 1986 suggest a good level, about the same as last year. But strong car sales increasingly are dependent on cut-rate financing and other inducements, as in the current round. One respected District analyst expects a small decline, about 2 percent, in total unit auto sales in calendar year

1986. Domestic makers may experience greater pressure than this if the Japanese "voluntary" quota on auto exports to the U.S. is enlarged or ended after March 31. Truck sales have been setting records, but strength is mainly in light trucks, with imports up most strongly. Sales of heavy trucks have weakened in the last half of 1985, but may have stabilized.

Steel. With inventories reduced to very low levels and imports below last year, steel prices have been firming. The lower value of the dollar and efforts to curb imports seem to be having some effect. Demand for steel remains generally slow, with 1986 expected to be similar to 1985. Strength is concentrated mainly in motor vehicles, light construction, and service centers.

Capital Goods. Demand for most types of mechanical capital goods has remained weak, but did not deteriorate further in 1985. An exception is farm equipment, which continued to decline. In 1986, cuts in capital spending are expected for electric power generating equipment, mining equipment, and oil and gas development. Sales of food processing machinery have picked up slightly. A new wave of paper plant construction is reported to be getting underway.

Nonresidential Construction. Construction activity in the District was hampered more than normally in November and December by bad weather. Contract backlogs for commercial buildings, highways, and apartments are large in the Chicago area. This work is proceeding in 1986. Demand for Chicago-area smaller manufacturing buildings has about exhausted the overhang of good, well-located unsold units. Among District states, the rise in nonresidential construction contracts in 1985 was strongest in Michigan, while Iowa showed essentially no growth. Nonresidential construction in the District is still well below levels of the late 1970s, compared with an increase in the U.S.

Residential Construction. Housing construction continued to increase in most District centers in 1985, while the U.S. probably was flat to down slightly. But the pace of residential construction in the District as a whole is only about half of good levels

of the late 1970s. In recent months, expansion has been strongest in Michigan, while activity has slipped further from low levels in Iowa. Existing home sales have been vigorous in the Chicago area, with little price appreciation. Fixed-rate, 30-year mortgages are being quoted by Chicago-area lenders with nominal interest rates as low as 10 1/2 percent, low compared with levels of the past 6 years. Adjustable-rate loans are being offered with first-year rates down to around 8 1/2 percent.

Consumer Spending. Large District retailers report that December sales, on a same-store basis, were flat to up slightly. An industry analyst described December and early January sales as disappointing and slow. Inventories have been kept low, and sales may have been hampered as a result. Catalog stock-outs were high (in-store sales lost due to low stocks cannot be measured). Appliance sales have been strong, especially home laundry, ranges, and refrigerators. Sales of microwave ovens, which have soared in recent years, are believed to have peaked in 1985. Inventories of appliances are in good balance except for a sizable stock of room air conditioners left over from a cool summer. Airline fare wars have intensified, with little response in terms of added traffic.

Agriculture. Recent developments have cast a more favorable light on an otherwise bleak picture for the District's agricultural sector. Federal legislation enacted December 23 extends farm income and price support programs for five more years and paves the way for financial assistance to the troubled Farm Credit System. Problems in the most troubled district of the FCS--Omaha, which serves Iowa--apparently have eased. Farm commodity prices, although still at low levels, have been on an uptrend in recent months. Crop prices in particular have been buoyed by record movements of grain under federal price support loans and by weather-related crop setbacks in the Southern Hemisphere. Land values in the District continued to decline in the fourth quarter, but the rate of decline apparently slowed. Observers increasingly believe land markets may bottom in 1986.

EIGHTH DISTRICT - ST. LOUIS

Summary

District indicators show a mixed outlook for the region and a continuation of the conflicting signals reported in November. District employment growth continues to lag national trends. Residential and nonresidential construction activity, however, has exhibited strong growth in the most recent quarter. Consumer spending also has shown stronger growth in the District than in the nation. Banking trends continue to follow a year-old pattern of sluggish growth in commercial loans and strong growth in consumer lending. The health of the local agricultural economy, as measured by agricultural finance data, points to continuing stress for farmers and their lenders.

Employment

District nonagricultural employment increased in October and November at annual rates of 2.5 and 1.4 percent, respectively, trailing the national rates of 4.3 and 2.2 percent. Nonagricultural employment in the District was 1.5 percent greater in November than it was a year ago; nationally, nonagricultural employment expanded 3.0 percent over the same period. The District unemployment rate increased slightly in November to 8.2 percent with decreases in Missouri and Tennessee offset by increases in the jobless rate in Arkansas and Kentucky.

Construction

For the three-month period ending November, residential and nonresidential construction contracts grew by 14.7 and 15.8 percent;

respectively. District residential contracts were 9.5 percent above year-ago levels, exceeding the national increase of 8.4 percent. District nonresidential construction, however, grew by only 4.9 percent compared with a 14.0 percent national increase.

Consumer Spending

District retail sales (seasonally adjusted) remained strong over the three months ending in October, growing at an 11.9 percent rate while retail sales nationally grew at only a 1.5 percent rate over the same period. Reports from the District, however, suggest some weakness in November sales.

Interviews of ten retailers in the four major cities of the District indicate moderate sales increases for the 1985 Christmas season. Increases ranging from 4 to 9 percent suggest District sales growth was similar to, or slightly above, national levels. The strongest sales increases were reported in Memphis and St. Louis. Compared with last year, retailers kept inventories more in line with sales and avoided more unplanned price markdowns. Most respondents reported profits similar to or slightly above 1984 levels.

Banking

Total loans outstanding at large weekly-reporting District banks grew at a 10.1 percent annual rate for the fourth quarter. Commercial lending continues to be sluggish, increasing at a modest 3.5 percent rate compared with a 16.7 percent rate of growth for the fourth quarter of 1984. In contrast, growth of consumer lending has remained strong over the fourth quarter (25.0 percent) relative to the same period last year

(18.0 percent). Consumer lending continues to be the fastest growing component of large District banks' loan portfolios.

Total deposits at large District banks grew at a 10.5 percent rate for the fourth quarter compared with a 12.1 percent rate recorded for the same period last year. This slower rate can be attributed to modest growth in MMDA's, which increased at one-half the rate recorded for fourth quarter 1984.

Agriculture

Data for the third quarter indicate that the volume of agricultural loans outstanding at District banks is 4.3 percent less than for the same period a year ago. Kentucky, Arkansas and Missouri exhibited the sharpest declines, with volume falling by 11 to 12 percent. Farm Credit System lenders in these states and Tennessee experienced even sharper drops as farm loan volumes fell by 24 to 28 percent from a year ago. The percentage of agricultural loans past due at agricultural banks has increased steadily over the last two years, rising from 2.4 percent in 1983 to 3.0 percent in 1984 and to 3.5 percent in 1985. Due to rising agricultural loan delinquencies, total loan charge-offs at District agricultural banks have risen from 0.4 percent of total loans outstanding in the third quarter of 1983 to 0.9 percent in the third quarter of 1985. Loan charge-offs at agricultural banks nationwide, however, were even larger, rising from 0.5 percent to 1.3 percent over the same period. Missouri's agricultural banks showed the worst deterioration of loan quality in the District as the percent of loans written-off increased from 0.5 percent in 1983 to 1.8 percent in 1985.

NINTH DISTRICT - MINNEAPOLIS

Some signs of strength were evident in the Ninth District's economy at year's end. District consumer spending appeared to be reasonably strong in December. Most district states' unemployment rates have stabilized, and some new, resource-based employment is opening up in the hard-pressed northern areas of Minnesota and Michigan. Late in the year, crop prices picked up slightly, but not nearly enough to significantly alleviate the district's rural economic problems.

Consumer Spending

District retail sales of general merchandise in December appeared to mirror the nation's upbeat performance. One chain reports that its stores in the Minneapolis-St. Paul metro area were among its highest gainers over the holidays. The discount operations of two other chains experienced very good sales growth throughout the district. Price markups generally held firm, which helped increase profits further. A member of this Bank's Advisory Council on Small Business, Agriculture, and Labor thinks that retailers in larger towns in eastern South Dakota had good holiday sales and that retailers in smaller towns there did better than expected, though not as well as last year. Small retailers in agriculturally dependent areas of the district generally continued to suffer from the effects of low farm income.

District sales of motor vehicles, which were strong throughout 1985, finished the year on an uptick. The regional office of a domestic auto producer reports that its December sales were well above its goal. A Bank director from Montana notes that car sales there increased by 20 percent between

1984 and 1985. And a former Bank director from western Wisconsin reports that an auto dealership in that area had its second-best year in 40 years.

Spurred by lower mortgage rates, housing activity in the Minneapolis-St. Paul metro area was vigorous at year's end. During November, housing permits taken out in the Twin Cities were far greater than a year earlier, as were December home sales in Minneapolis. This strong performance raised Minneapolis home sales 17 percentage points above the 1984 level.

Tourist spending, an important source of income in parts of the district, has been uneven this winter. Skiing in Montana was hurt by poor snow conditions, but early snowfalls in northern Minnesota stimulated both skiing and dogsled racing. A Bank director from the Upper Peninsula of Michigan says that snowmobilers there are spending lots of money pursuing their hobby.

Employment

Although the district states' unemployment rates worsened somewhat late in the year, part of the increase in unemployment rates was surely due to seasonal variations. Also, a lessening of construction employment may have been due to unseasonably cold November weather. Moreover, attempts to seasonally adjust Minnesota's employment indicated that it rose slightly between October and November, as did districtwide employment.

Several noteworthy labor developments occurred in hard-pressed northeastern Minnesota. These include progress on plans to build a large paper mill employing 600 workers in Duluth; the possible reopening of a fiberboard insulation plant somewhere in the area; and the resumption of operations at two taconite plants that will return nearly 2,000 temporarily unemployed workers to their jobs.

Resource-Based Industries

Conditions varied among district resource-based industries at year's end. Oil and gas activity in North Dakota and Montana declined from 1984 levels, matching the low prices that caused the condition. Coal production in Montana showed no increase during the past year. Taconite shipments from plants in northeastern Minnesota are expected to be slightly less in 1986 than they were in 1985. However, in the Upper Peninsula of Michigan, a big copper mine that reopened recently plans to add 300 more workers in 1986. There are also plans to build a taconite plant in the Upper Peninsula to test a new cost-reducing technology. This technology has the potential to significantly improve the competitiveness of the district's taconite industry.

Agriculture

A few signs of slight improvement in the district's agricultural sector occurred during the fourth quarter. Small improvements in cash prices for corn, soybeans, and wheat raised the Minnesota farm price index a bit in November and held it firm in December. This Bank's most recent survey of district agricultural bankers found that fewer bankers, although still a majority, expect farm earnings to decline in the short term. However, the fact that fewer of these bankers are seeking new farm loan accounts underscores their apprehension about the farm situation. Finally, cattle operations in the district have been hurt by recent price declines and expensive hay.

TENTH DISTRICT - KANSAS CITY

Overview. Economic activity in the Tenth District appears to have improved slightly around yearend, with further improvement expected in 1986. Christmas season sales, though not up to retailers' expectations, contributed to a moderate increase in final quarter sales. Though auto sales were sluggish at yearend, dealers are cautiously optimistic for 1986. Inventories of retail goods and industrial materials are generally viewed as satisfactory. Prices are expected to be relatively stable both for inputs and at retail. Homebuilders are optimistic for 1986 in spite of some weakness in 1985. Savings inflows to thrift institutions are expected to increase and mortgage rates are expected to stabilize. Total loan demand is stable and total deposits are higher at commercial banks. Farm liquidations and foreclosures remain a problem, in spite of some improvement in yearend loan paydowns.

Retail trade. Retailers report a moderate increase in sales for the last three months of 1985 over the same period a year earlier. Clothing sales have been strong while home furnishing sales have been weak. Sales are expected to increase slightly through 1986. Prices have been stable and are expected to remain so. Generally, retailers are satisfied with their inventory levels and expect to maintain them throughout 1986. Sales for Christmas 1985 were relatively strong but not up to retailers' expectations.

Automobile sales. Auto sales, healthy for most of 1985, slowed by yearend. But new factory incentives and credit market conditions in general continue to have a positive impact on sales. Dealers are cautiously optimistic about new car sales in 1986. Most new car dealers are generally satisfied with their inventories. Colorado dealers report that inventories of used cars are too high, as factory sponsored financing on new autos has resulted in a glut of used cars.

Purchasing agents. Most purchasing agents surveyed had not experienced price increases in the past three months and expect prices to remain fairly stable through 1986, due to an ample supply of materials. Some firms have trimmed materials inventory levels in recent months but most report that current levels are satisfactory.

Housing activity and finance. Area homebuilders report that housing activity in 1985 was generally below that of 1984, but they are somewhat optimistic for 1986. Housing starts in 1985 were fewer than those in 1984. Both prices and sales of new homes were generally at or slightly below 1984 levels. Most area homebuilders expect housing starts, sales of new homes, and prices of new homes for 1986 to be at or slightly above 1985 levels. Prices of most housing materials in 1985 remained close to 1984 levels, with stable to slightly lower materials prices expected for 1986.

Savings and loan institutions give mixed reports regarding current savings inflows relative to a year earlier, but they expect savings inflows to increase in 1986. Respondents report constant mortgage demand and commitments and expect little change. Mortgage rates have been falling and most respondents expect them to remain at present levels in 1986.

Banking. Total loan demand was stable and total deposits were higher at Tenth District banks compared with a month earlier. Consumer loans, commercial and industrial loans, and residential real estate loans were generally constant. Commercial real estate lending decreased at most of the banks surveyed, while agricultural lending was steady to slightly lower. Tenth District bankers did not change either their prime rate or their consumer loan rates during the last month, and most did not anticipate any rate changes in the near future. Total deposits rose at Tenth District banks. Most respondents report higher levels of demand deposits and MMDA's. Super

NOW accounts, small time deposits, and large certificates of deposit typically were constant, while changes in NOW accounts were mixed. Passbook savings accounts continued their recent pattern of decline. Bankers are beginning to see the usual seasonal inflows into IRA and Keogh accounts. Tenth District banks, in general, have not changed the minimum balances on their Super NOW's and MMDA's in response to recent deregulation. Several bankers were considering changes in minimum balances, however, though most respondents doubted significant effects on the kinds of deposits held by bank customers.

Agriculture. Paydowns on agricultural loans at the end of 1985 generally were reported to be satisfactory in the Tenth District. For most banks, 1985 marked an improved yearend paydown situation over a year earlier. Excellent crop yields and stronger year-end livestock prices accounted for the better than expected loan situation. Even so, bankers report that they will not carry all of their current farm accounts through 1986. Some borrowers are being sent to alternative lenders, while in cases of extreme financial stress bankers are urging operators to liquidate part of their assets. Voluntary farm liquidations are running above normal in most areas. Few bankers are resorting to foreclosure as an immediate solution to failing loans, though most indicate that foreclosure is a future possibility for some borrowers. Farm Credit System (FCS) lenders in some parts of the district have not had as much foreclosure flexibility as the commercial banks. FCS outlets operating under a burden of troubled loans continue to follow strict loan review guidelines. Bankers report that the recent FCS bailout legislation has done little to alter the behavior of the FCS outlets in their areas. Only a slight upswing in equipment sales was evident at the end of 1985.

ELEVENTH DISTRICT - DALLAS

The Eleventh District economy remains sluggish. Manufacturers report little overall change in activity. The weakening of oil prices has led to significant declines in the drilling rig count. The value of construction contracts has begun to fall significantly. Retail sales are growing, albeit at a slow rate. Automobile sales are weak compared to the fall, but a new round of dealer incentives is expected to increase sales. Asset expansion remains quite slow at the large banks. District farmers and ranchers continue to face weak prices for crops and livestock.

Manufacturers' sales remain flat in the District, with gains in some sectors offset by lower demand in others. The weak energy industry and slowing construction remain the prime sources of declining orders. Stone, clay and glass producers note increasing glass demand from the transportation sector, but they report that sales to the construction sector are slipping. Demand for lumber and wood products is declining as a result of reductions in home building. Decreased import competition and the lagged effects of past increases in construction contracts have led to recent increases in sales of primary metals, according to manufacturers. Fabricated metal producers' sales to the energy and construction industries are ebbing. Demand for nonelectrical machinery, both from other manufacturing industries and from energy-extraction firms, is sluggish. Respondents at electrical equipment firms say orders for their products are increasing due to rising non-energy demand and because their customers have run down excess inventories of semiconductors. Sales are unchanged for chemical and allied products manufacturers. Buoyed by strong winter demand, both output and profit margins at District refineries are said to be high.

The outlook for oil prices has forced the drilling rig count to its lowest level since 1976. The decline has been steeper in Texas than in the rest of the nation. Well permits, a leading indicator of drilling activity, edged up in Texas in November, but permits dropped in Louisiana. The seismic crew count, another indicator of future drilling, continues to fall.

The value of construction contracts has fallen for three straight months in the District states. The decline is steepest for nonresidential building, although residential has also fallen significantly. The levels for both categories stand substantially below those of a year earlier. The reduction in nonresidential contract values can be seen in most categories of buildings, but particularly in office construction. Recent declines in residential construction are part of an ongoing trend. Single-family housing permits were 20 percent below the 1984 level, which was 30 percent below that of 1983. Nonbuilding construction continues at a strong level.

Respondents report that retail sales growth in December was slightly stronger than expected. Profits were higher than a year earlier, as discounting was less common than in the previous Christmas season. Sales of women's apparel and other soft goods have risen faster than those of big ticket items, such as home appliances, electronics, and furniture. Retailers are keeping inventories low in expectation of slow sales growth in the near term.

Automobile sales have recently weakened. Dealers link the current slowdown to last fall's unseasonally large increase in sales, which occurred in response to manufacturers' special interest rate incentive programs. The decline is also attributed to buyer anticipations of a new round of

incentive programs. The recent ebb in sales has led to excess inventories of some domestic autos, but import dealers complain of shortages.

Despite an increase in growth over the November rate, total loans at the District's large banks rose in December at a pace substantially below the monthly average for the year. Business loan growth increased slightly in December, but the average level of business loans for the fourth quarter was below its year-earlier level. The value of consumer loans in December remained below a year earlier, as it did in all months of the fourth quarter of 1985. Real estate loan growth declined in December, as it had throughout the year. The rate of deposit growth at large banks also declined in December, continuing a pattern that began in March. Deposit growth has also slowed at all District financial institutions.

District agricultural crop prices in December were essentially unchanged from a year earlier, while livestock prices were 6.5 percent below their of December 1984. Foreign demand for cotton continues to fall, with the current season's exports now projected to be less than half those of a year earlier. Despite reduced supplies, lackluster demand kept District livestock prices, which normally turn up at this time of the year, slightly lower in December than November.

TWELFTH DISTRICT — SAN FRANCISCO

Summary

The Twelfth District economy appears to be improving, although problems in some sectors continue. In general, urban areas in the West are more prosperous than are rural areas. The Christmas season was a good one for most retailers. Low prices continue to trouble many agricultural producers, although the recent drop in the value of the dollar has already improved sales of almonds and winegrapes, two of the District's most important cash crops. Electronics activity is uneven, with a boom for defense related firms and continuing troubles for non-defense firms. Forest products industries, while still troubled, show some signs of improvement. Overall, construction activity remains healthy, despite substantial geographical variations. Lower interest rates are increasing the volume of mortgage applications, but refinancing appears to account for much of the increased activity.

Consumer Spending

Preliminary information suggests that most parts of the District had strong Christmas selling seasons. In Oregon, Christmas sales were disappointing, with volume 5 to 10 percent below last year's, but for the year as a whole Oregon's retail sales grew 20 percent. Auto sales in the fourth quarter appear to have been flat or down in most areas. The reduced value of the dollar has had little impact on imported car prices as yet, although an Oregon respondent reports that sticker prices on Japanese cars have started to climb.

Agriculture

Soft prices continue to cause concern among many farmers and the mood

in most agricultural parts of the District remains gloomy. The situation is brighter for producers of some specialty crops, including some types of nuts, vegetables, and fruits. The reduced value of the dollar has already provided a boost to almond sales abroad and put a damper on wine imports to the U.S., which provides appreciated good news to some California growers but little comfort to farmers elsewhere in the District.

Manufacturing and Mining

Electronics industries continue to suffer in many parts of the district. Despite recent much-publicized increases in semiconductor orders, many semiconductor firms continue to announce layoffs and either losses or sharply declining profits. In contrast, Seattle-area firms, which produce primarily for defense purposes, appear to be doing quite well. Snohomish County in Washington, for example, is experiencing substantial growth in high-tech investments and commensurate growth in its residential construction activity.

The forest products industries continue to suffer. The recent drop in the value of the dollar is unlikely to help forest products companies, because they compete primarily with Canada, whose dollar has remained stable vis-a-vis the U.S. dollar. Nevertheless, a recent survey of 60 Oregon forest products companies found that only three were unprofitable in 1985. Many of the profitable firms made only slim profits, however.

In Nevada, gold and silver mining activity is expanding. In 1985, 100 million ounces of gold were mined in Nevada, a 100 percent increase from 1984's total. Mining activity for other metals, such as copper, remains depressed.

Construction and Real Estate

Construction activity varies both among locations in the Twelfth

District and among different types of building. For the most part, building is healthier in larger metropolitan areas than in the more rural parts of Twelfth District states. One exception is the agricultural Central Valley of California, where respondents report that both residential and nonresidential building are healthy. Many areas, particularly urban centers, report high vacancy rates and oversupply in multifamily housing and in commercial space. In some such areas, including Southern California, the boom continues despite high vacancies and low absorption rates, but other regions, including Salt Lake City, report declining activity in response to oversupply.

Financial Sector

Interest rates on 30-year fixed rate mortgages have fallen in most parts of the Twelfth District, and are now close to 11 percent in some areas. Consequently, the number of mortgage loan applications is up substantially in most parts of the District. It is not clear, however, that the increase in applications reflects increased home buying activity. Respondents invariably report heavy refinancing activity, and some attribute the entire increase in applications to refinancing rather than home purchases. Some respondents suggest that home buying activity is being dampened by tightened lending standards instituted in response to increased mortgage default rates. With lower rates, variable rate instruments are used only rarely in most areas, although one respondent reports that in California, where variable-rate mortgages have been historically more popular than elsewhere, over half of all mortgage commitments are made through variable rate instruments.