

SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICTS

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SUMMARY*

The pace of economic activity appears to have quickened slightly at year-end, according to this month's commentaries on regional economic conditions. Retailers in most Districts enjoyed moderate year-over-year sales increases, in line with expectations. Auto sales were very strong in December, although the loss of the sales tax deduction in 1987 is widely regarded as the reason for this strength. Manufacturing employment increased in several Districts. The improvement was spotty, however, with an industry expanding in one District but not in another. Residential construction activity remains strong in some Districts, but has slowed in others. The rate of nonresidential construction also varies considerably from one part of the country to another. Oil and gas drilling is gradually increasing from very depressed levels. The agricultural situation is improving. While agricultural prices remain weak, higher production levels and lower prices for petroleum-based inputs are positive factors. Banks in most Districts experienced very strong commercial and real estate loan demand in December. Some of this strength is attributed to efforts to complete transactions before the new tax laws are in effect.

Consumer Spending

Christmas sales in most Districts were described as moderately ahead of year-ago levels and consistent with retailers' expectations. The most notable exceptions were the Boston and New York Districts, where retail respondents reported strong sales increases ranging from 5 to 25 percent over year-ago levels, and the Dallas District, where sales were

*Prepared at the Federal Reserve Bank of Boston.

said to be below year-ago levels although still consistent with expectations. Sales were generally slow in the early part of December but strengthened as Christmas drew closer. January sales were reported as healthy in the Philadelphia District and weak in Richmond.

Retail inventories at the end of the Christmas season were said to be at comfortable levels and, in two or three Districts, lower relative to sales than in past years. For the most part, changes in exchange rates have not had much effect on retail prices, although merchants in several Districts expect rising import prices to show up more in 1987. Retailers are generally optimistic about future sales, but there is some concern that the first quarter will be soft as consumers start paying for the cars and other large items purchased late in 1986.

Reports of motor vehicle sales were all the same. Sales were very strong in December; dealers are generally satisfied with current inventory levels; sales are expected to be slow for at least the first several months of 1987. Most reports attribute the strength in December and the weakness projected for early 1987 to consumers' shifting purchases from 1987 to 1986 in order to take advantage of the deductibility of the sales tax. In this regard, San Francisco notes that in Oregon, where there is no sales tax, sales did not pick up appreciably.

Construction and Real Estate

Reports of residential construction were mixed across the Districts. Activity has been particularly strong in the New York, Chicago and St. Louis Districts. Mild weather was said to have contributed to the strength in New York. Where home building has slowed, overbuilding,

overpricing and a shortage of suitable land were cited as the primary causes. In the San Francisco District, multifamily construction has slowed but single-family building is doing well; the new tax laws are thought to have made multifamily units less attractive for investment purposes, whereas they are expected to have little effect on the single-family unit. Home sales are strong, according to most reports, and are expected to remain so into 1987.

Nonresidential construction levels vary from busy in Minneapolis and Chicago to slow in San Francisco. About half the Districts mentioned that some office markets face an oversupply of space; absorption rates are said to be strong in many areas, however. Similarly, in areas with newly constructed retail space, occupancy rates are improving. Construction for retail buildings has continued at a healthy rate in Atlanta, in part because of net in-migration. Substantial growth in nonresidential construction was reported in parts of the Chicago and St. Louis Districts.

Manufacturing

Manufacturing activity appears to have picked up slightly in the last months of 1986. Several Districts reported modest increases in employment, and in the Dallas District, where manufacturing activity had been declining, "Manufacturers are noting more positive signs than at any time in the last two years." The industries cited as responsible for this improvement varied from District to District: in the Dallas District orders are bottoming out for energy-related durable goods; San Francisco reported that commercial aerospace is gaining strength; employment increases occurred in glass and general industrial machinery in the

Cleveland District, in textiles and electrical equipment in St. Louis and in printing and publishing and textiles in Atlanta. Several Districts mentioned increasing defense activity. For many industries, however, there appears to have been no improvement. San Francisco noted that the electronics and semiconductor industries continue to suffer from fierce competition and low prices. Boston and Chicago both reported that reduced capital spending by domestic auto manufacturers is hurting the machinery and metalworking industries.

Manufacturers in different Districts vary considerably in their views of the future. Those in the Philadelphia and Richmond Districts think that business will improve over the next six months, those in Boston foresee little change, and those in Cleveland expect the first quarter of 1987 to be very poor and are uncertain whether the national expansion will continue.

Mining

The number of oil and gas drilling rigs in operation increased in December in the Kansas City and Dallas Districts, but remains far below the number a year ago. Drilling in Atlanta was at its highest level since last spring. Coal production increased over the year in the Richmond District but decreased in Atlanta. Gold mining in the Minneapolis District is reported to be doing fairly well and the San Francisco District's copper industry is hiring after an extended period of layoffs.

Agriculture

The situation in agriculture shows some signs of improvement. Agricultural prices remain generally weak, but low grain prices have helped

livestock producers, especially those raising poultry. Lower prices for petroleum-based inputs such as fuel and fertilizer are also a positive factor. Prices rose slightly in December for wheat, corn and soybeans in the Minneapolis District and farm crops in Texas, but most prices remain below year-earlier levels.

Farm incomes are not as weak as farm prices in all cases, since production levels are higher. Good weather contributed to a bountiful vegetable and citrus harvest in Florida, more calves were held over the winter in the Kansas City District, and crop production in the Richmond District should be higher than this year's drought-reduced levels. On the down side, a significant decline in Texas cotton production projected for 1986 means lower incomes in already distressed areas of the state.

Banking

In most Districts, commercial and real estate lending increased strongly in December, although in the Dallas District business loans were far below year-ago levels. Banks in the New York, Philadelphia and San Francisco Districts attributed some of December's strength to tax changes and the desire to complete transactions before year-end. In the Philadelphia and Atlanta Districts consumer loan growth has slowed and in San Francisco construction loans dropped off sharply in the last months of the year. Home equity lending is increasing, according to several reports.

In the St. Louis District agricultural lending by banks continues to decline as a result of reductions in the costs of inputs and land, on the one hand, and more rigorous scrutiny by lenders, on the other. In the Kansas City District loan paydowns are reported to have improved over last year.

FIRST DISTRICT-BOSTON

Retailers in the First District enjoyed strong year-over-year holiday sales. Manufacturing activity, on the other hand, remains flat. Export sales have increased, but the improvement is small. Orders of capital equipment from the auto industry have fallen sharply. Although some retailers report that vendor prices are rising faster than a year ago, others see no acceleration. The prices of manufacturing inputs are stable. Commercial construction activity is said to be down from the level of the past two years, but still high by the standards of earlier years.

Retail

Christmas selling results in the First District were mixed; but among those contacted, the weakest year-over-year sales increase still exceeded 5 percent on a comparable stores basis. Some retailers enjoyed increases ranging as high as 25 percent. Several respondents noted that the season started slowly but became almost frenzied in the last week or so; margins suffered at stores that responded to the early weakness with price reductions. Electronics, VCRs, TVs, and microwave ovens continued to sell well. Selected apparel categories picked up. Pre-holiday toy sales showed significant growth.

Inventories are said to be in good shape. A number of stores have made significant efforts in the last year to reduce inventory levels. Several of those contacted reported that post-holiday inventories are no greater than last year even though they are supporting significantly higher sales.

Some merchants report domestic and foreign vendor prices rising somewhat faster than a year earlier, others note very little change. One of those facing rising import prices plans to shift from Japanese suppliers to Korean. Another said that even after sizable price increases six months ago (which have since leveled off), foreign hardgoods suppliers offer better quality relative to price than domestic competitors. One firm expects its import prices to increase more in 1987 than in 1986; this firm orders up to a year in advance and by buying foreign currency when the orders are placed, it locks in exchange rates.

Retailers continue to report difficulties in finding high-quality employees in the tight New England labor market, even as they reduce staff after the holiday season. This situation gives them confidence that the region's consumer sector will remain robust in 1987.

Manufacturing

Most manufacturing respondents in the First District report that business remains flat. However, in the metalworking and machinery industries there has been a substantial falling-off in orders from auto makers. Various manufacturers of capital goods report that the chemical industry is increasing orders, defense demand remains strong, but orders from the oil and gas industry remain depressed. Several contacts in the computer industry have experienced moderate increases in demand.

Exports have picked up, but the improvement is modest. Europe accounts for most of the gains. In addition, several manufacturers of large-scale capital goods are experiencing increased success competing against Japanese and German suppliers in third country markets, particularly in the Far East. Most manufacturing respondents do not see any lessening in import competition, but a representative of the textile industry reports that the prices of European products have increased

and U.S. mills have regained a little market share. None of the firms contacted is shifting production to the United States to take advantage of the lower dollar. On the contrary, several are expanding overseas operations, in some cases with the intention of exporting to the United States.

Manufacturers in the First District do not expect 1987 to be much different from 1986. Seeing little growth potential, they are focusing attention on cost containment. Many have reduced employment levels in the past year; several are continuing to do so. Administrative staffs are being reorganized and reduced. Manufacturers are also continuing to cut inventories through the use of more computerized controls and just-in-time procedures. Respondents are reasonably satisfied with their progress in reducing inventory levels, but they are trying to bring them lower still. With respect to capital spending, most contacts plan to spend about the same in 1987 as in 1986. Two themes were heard, often from the same individuals: 1) approval standards are very stringent and 2) if the project will yield substantial productivity gains, it will be approved.

Prices of inputs, whether imported or domestic, are not rising to any significant degree. One exception is the price of raw wool from Europe. Manufacturers also report a continued inability to raise their own prices.

Commercial Real Estate and Construction

The commercial real-estate market is healthy for the most part, according to local agents. Boston, despite the addition of a significant amount of new commercial space, still enjoys one of the highest occupancy rates of any city in the country. Agents in most areas in the region are reporting a strong market for office space. Construction in this sector continues but at a level somewhat below that of the past two years.

Where over-building has been reported, absorption rates are said to be catching up with vacancy rates. Retail space is tight in many suburban and prime downtown locations. Other than the current expansion of some rural shopping malls, little retail construction is underway. Reports were mixed for industrial real estate. While some agents report high vacancy rates, others suggest an even match between supply and demand. Industrial space in some locations has priced itself out of high occupancy by charging retail rents for industrial footage. Other industrial sites are being converted to research and development and other uses that generate higher revenues.

SECOND DISTRICT - NEW YORK

Conditions in most sectors of the Second District economy were stable to improved in recent weeks. Consumer spending during the holiday season was at or above expectations and inventories were generally low going into the new year. Residential construction remained strong, in part because of mild weather. An increased number of firms however, reported a worsening of business conditions, although the majority continues to experience stability or improvement. On the financial side, lending activity increased substantially during late 1986 at mid-sized banks in the District.

Consumer Spending

Consumer spending at Second District stores ranged from 6 to 23 percent above year-earlier levels during the 1986 Christmas season, and several retailers reported sales above plan. After a strong post-Thanksgiving period, sales activity slowed in early December as buyers apparently waited for the pre-Christmas markdowns which had been the pattern in some recent years. Most retailers had entered this holiday season with slim inventories, however, and refrained from offering additional promotionals. As the holiday drew nearer, a decided upturn in sales occurred and most retailers ended the season with overall sales at or above plan. One department store chain with somewhat disappointing sales attributed this to a special promotional in November which detracted from its December business.

Among items in strong demand were apparel, jewelry and electric appliances. In addition, a new laser toy proved so popular that stores could not keep it in stock. As the new year began, most stores reported inventories at quite comfortable levels.

Business Activity

The Second District's economic expansion slowed somewhat in recent weeks. Most purchasing managers in Buffalo and Rochester continue to report stable to improved new orders and production. However, the percentage of firms with declining business conditions has been rising, and in November such firms surpassed the number with improved situations for the first time in several months.

Employment remains at a record level in the District as declines in manufacturing have continued being offset by gains in other sectors. Moreover the December unemployment rates of 4.3% and 6.0% in New Jersey and New York, respectively, were below the national average. However, a development which could have an adverse impact on District employment is A.T.& T's recently announced plans for a 27,400 reduction in its workforce by the end of 1987. While no information was given as to where the cutbacks would occur, some 67,000 of the company's employees are in the New York-New Jersey area.

Construction and Real Estate

Residential construction continues to be strong in the Second District. Aided by the lack of frost and unusually warm weather, builders have remained quite active working on contracts from the fall. A scarcity of suitable land is a growing problem in some areas and rising home prices

are widespread. Developers are increasingly resorting to subdivisions in order to keep house prices at affordable levels. Despite these problems, builders are generally optimistic that 1987's activity will come close to matching the busy pace of 1986.

Office market conditions were relatively stable in recent weeks with few major new projects undertaken. Additional leasing activity continues to help in areas of oversupply. Moreover, some observers anticipate an actual tightening of the office market on Long Island because of the unabated demand and limited construction activity there. In Manhattan, opinions are mixed concerning the likely impact of the recent collapse of rental negotiations for the last of the World Trade buildings. Some anticipate a sizable increase in the downtown vacancy rate as these 2 million square feet of new office space re-enter the market, but others believe it can be absorbed without much difficulty.

Financial Developments

Mid-sized banks in the Second District report that lending activity increased dramatically in late 1986. The surveyed banks attributed the increase primarily to changes in the tax code which encouraged transactions to be completed by year end. The changes include the future elimination of investment tax credits, a higher capital gains tax rate, and less favorable treatment of depreciation expenses. All of the banks surveyed stated that last minute merger and acquisition activity was not a factor in the loan surge. In general, real estate loans, which had been strong throughout the year, increased the most. The banks added that they expect demand for both real estate loans and small business loans to increase further during early 1987.

THIRD DISTRICT - PHILADELPHIA

The Third District economy appears healthy, although growth in several sectors has slowed recently. Manufacturing activity was only steady in January, following six consecutive months of expansion. Retail sales during the holiday shopping season met merchants' plans, which called for modest year-over-year gains, and they have been enjoying a healthy rate of sales since Christmas. Automobile sales were high in December but low in January. Total loan volume at major Third District banks was growing slowly as 1986 came to a close, although real estate lending remains strong.

Expectations for the Third District economy are generally positive. A majority of manufacturers polled in January predict steady or improving business during the first half of the year. Retailers also expect a good year, but express some concern that consumer debt burdens could limit discretionary spending. Automobile dealers say it will be several months before the slack following the December rush of car sales is reversed. Bankers expect business lending to parallel moderate economic growth in 1987, but they believe consumers will not be willing to add much to their current debt levels.

MANUFACTURING

After posting six consecutive monthly gains, the Third District manufacturing sector is pausing in January, according to the latest Business Outlook Survey. Overall, business is running at a steady rate in both the durable and nondurable goods sectors. While firms reporting improved business in January edged out those reporting slower business, they did so by only a slim margin. This lull is reflected in most measures of industrial activity. New orders are up fractionally, but shipments, order backlogs, and inventories are

virtually unchanged. Employment is also at a standstill.

Industrial prices in the area are mostly stable; 80 percent of the firms contacted in January said both input and output prices were unchanged from December. However, 15 percent noted increased costs for the goods they purchase, and 12 percent charged more for their own products.

In their outlook for the first half of 1987, local manufacturers have mostly positive views. Forty-three percent of the January survey respondents expect continued growth and 38 percent anticipate steady conditions; only 15 percent forecast a slowdown. Overall, survey respondents expect increases in orders and shipments. They remain cautious, however, and are planning no changes in either employment or capital spending schedules during the next six months.

RETAIL

Retailers generally made their modest Christmas sales targets, averaging 4-5 percent over 1985, after a late burst of buying. Year-over-year gains varied widely by type of store, however. Specialty retailers recorded the best increases, with sales at some stores up around 10 percent from the previous year; general merchandise stores posted gains at the lower end of the scale. Clothing and housewares were the best performing product lines. Going into the holiday season, inventories were leaner than in previous years; thus, retailers did not resort to unplanned markdowns despite the slow start of Christmas buying. Store executives contacted in January said their inventory-to-sales ratios remain about where they want them. Automobile sales were strong in December as buyers took advantage of the expiring sales tax deduction, according to dealers.

Retailers are optimistic that the healthy rate of sales so far in January indicates a good year ahead. However, some express concern that discretionary

spending could lag, as consumers make payments on automobiles and other high-priced merchandise purchased late in 1986. Automobile dealers reported a sharp slowdown in sales in January, which they attribute to the shifting of purchases into 1986; they do not expect sales to pick up for several months.

FINANCE

Total loan volume at large Third District banks edged up slightly during the first three weeks of December, and near the end of the year stood approximately 15 percent above the December 1985 level. Real estate lending is especially robust, and commercial lending is also strong. Bankers say loan demand in these categories was high near the end of the year due to tax changes which became effective January 1. Lending officers expect commercial and industrial loan demand to grow this year at nearly the same rate as it did in 1986, provided the economy does not weaken. But bank profits may come under pressure despite a healthy economy. Although still a minority, an increasing number of Third District banks say their net interest margins may shrink this year as a result of increased competition in lending to the middle market and a slowdown in deposit growth.

Growth in consumer loan volume at major Third District banks tapered off during 1986, and near the end of the year consumer credit outstanding was approximately 10 percent above the December 1985 level. This is a continuation of a trend to slower growth in consumer lending that began in the second half of 1985. Local bankers generally believe that consumers are approaching the limit of their willingness to add to debt burdens. Nevertheless, home equity lending appears to be increasing, prompted by the new tax law and strong promotion by banks. A significant portion of this new lending reflects consolidation of bank and merchant credit card debt, however.

REAL ESTATE

Commercial and residential real estate markets in the Third District are active, and most real estate contacts expect healthy conditions in 1987. Demand for office space continues to absorb new construction; new buildings are substantially pre-leased, especially in the Philadelphia and Wilmington central business districts. There is more slack in suburban areas, and leasing activity is expected to decline somewhat this year in these outlying markets. For industrial properties, realtors forecast stable or slightly easing demand this year.

Residential real estate activity is strong. The average rate for 30-year fixed rate mortgages has fallen to around 9 percent in the region, and realtors say this enables a substantial number of buyers to afford homes for the first time. Consequently, sales and prices rose throughout 1986, and realtors expect this trend to continue. However, builders note increasing resistance to higher prices for newly constructed homes. One large mortgage lender is predicting a 10 percent decline in housing starts in the region this year, but most builders think this is an overly pessimistic view.

FOURTH DISTRICT - CLEVELAND

Summary

As regional businesses close the books on 1986, the consensus is that the past year did not stand up to their initial high expectations. The first quarter of 1987 is marked by uncertainties about the effect of the recent tax reform and about the length of the current recovery. At present, economic indicators show a moderate increase in production, new orders, and retail sales and a slight reduction in inventories.

Retail Sales

A late holiday shopping spree helped many retailers recover from slow sales early in the season. Sales continued to be strong after the holiday season due partly to post-Christmas bargains and mild weather. Retail sales grew at a 5 to 6 annual percentage rate throughout the fourth quarter. Low profit margins by foreign manufacturers and importers have lead some retailers to expect import prices to rise at a 3 to 5 percent annual rate over the next quarter.

Domestic automobile sales were up as much as 50 percent over sales a year ago. Most of the increase is reportedly due to changes in the tax laws. Consequently, sales so far in 1987 have been weak. One dealer commented that sales were the slowest in 4 years. Since most dealers anticipated the year-end rush, inventories are reported to be at "comfortable" levels.

Import dealers reported similar sales volumes. Some foreign car dealers feared that a weak dollar may result in price increases for cars produced abroad.

Labor Markets

Ohio added 19,500 new jobs in November, increasing total employment by 0.43 percent compared to 0.27 percent growth in the country as a whole. This increase brought the Ohio unemployment rate to 7.2 percent, just slightly higher than the national rate.

First quarter 1987 projections by the Manpower Incorporated Employment Outlook Survey suggest that this region's employment growth will be slower than the nation as a whole. However, three of the largest cities in the District have outlooks better than those of the nation. These include Pittsburgh, Columbus and Cincinnati. Employment increases are expected services, wholesale/retail and durable manufacturing, while job losses are expected in finance, insurance and real estate.

Manufacturing

Manufacturers report for November an increase in new orders, production, and prices and a reduction in inventories from the previous month. Total manufacturing employment increased slightly in November, although it is over 2 percent below its level of a year ago. The recent gain came exclusively from durables, which were up 1.2 percent. Glass and glassware, and general industrial machinery led the monthly employment increases.

Steel production in Ohio fell by 3 percent during November, approximately the same rate of decrease as U.S. production. However, since November of 1985, steel production increased 8 percent in Ohio while falling 20 percent nationwide. Consequently, Ohio's share of total tonnage produced in the U.S. rose from 15 percent to 20 percent over the

last year. LTV recently announced intentions to spend \$500 million over the next two years to improve its flat-rolled steel division.

Uncertainty about the ability to sustain the recovery much longer and the effects of tax reform have generated pessimism among business executives, especially in Northeast Ohio. Respondents of a recent survey expected the first quarter of 1987 to be the worst in three years. Twenty percent of businesses surveyed reported unplanned expenditures in 1986:IV in order to take advantage of the old tax laws, and the same percentage indicated cut backs in spending plans in 1987 because they lost investment incentives. In addition, a record high percentage (20%) of business executives expected no profits in the first quarter of 1987.

Housing

Housing is at a seasonal ebb. The level of seasonally adjusted housing construction and the volume of mortgage lending in 1987 is expected to remain at moderate levels in most markets. Builders expect strong demand for single-family homes because of tax reform and low mortgage rates. However, the shortage of developable land may slow some housing starts, especially in the Columbus and Cincinnati areas.

The consensus among those interviewed is that mortgage rates will decline during the first half of 1987, but will rise slowly during the second half. Lenders report keen competition for mortgages and have been forced to drop interest rates. They are partially offsetting the lower rates by charging higher points. Mortgage refinancings are a small proportion of current volume, but most lenders expect another wave of refinancings if mortgage rates decline another 50 to 75 basis points.

Banking

District loan demand strengthened considerably over the past several weeks. Loans outstanding in all major categories grew substantially in the last two months, particularly in December. Commercial and industrial loans expanded at an annual rate of over 65 percent in December, up sharply from little or no growth experienced in the fall and summer months. In addition to the turnaround in business loan volume, consumer and real estate lending also accelerated in December from their already high levels.

However, loan demand may soften in the next few months as both manufacturing and nonmanufacturing companies surveyed have reported that outside financing is considered unlikely in the next few months.

FIFTH DISTRICT - RICHMOND

Overview

Manufacturing has resumed its rise after leveling off late last year from an upward trend that began in midsummer. Producers are even more optimistic than a few weeks ago about prospects for their businesses in the months ahead. Coal production has increased in recent weeks and further increases are expected as the year progresses. In retailing, sales were weak in early January, but inventories are at desired levels, prices are mostly unchanged, and revenues are expected to rise again soon. In the District economy as a whole, somewhat slower growth is expected in 1987. The region's farmers, however, should enjoy a significant increase in income.

Consumer Spending

Retail sales activity was weak in early January, according to our survey. Fifty-six percent of the respondents report seasonally adjusted declines in sales and employment. Retail inventories appear to be in line with expectations; retailers are optimistic that business will improve in the coming months and they are restocking accordingly.

Seventy percent of responding retailers report no change in the prices of the goods they sell or in the cost of goods they buy. Among the remaining 30 percent, those reporting price increases outnumber those reporting declines.

Manufacturing and Mining

Our survey indicates an increase in the seasonally adjusted pace of manufacturing activity in early January as compared with December.

Thirty-seven percent of the respondents report January-over-December increases in shipments and 24 percent report declines. In our previous survey, 29 percent reported November-over-October increases in shipments and 27 percent reported declines. Manufacturing employment appears to be up slightly in January; only six percent of the respondents report fewer employees, 77 percent indicate no change, and 17 percent report more workers on the job. Nondurable goods industries continue to show greater strength than durable goods industries, although furniture industry representatives report further increases in activity.

The manufacturing outlook also appears to be improving. Among respondents, 35 percent report increases in new orders and 25 percent report declines. In the previous survey, increases were reported by 25 percent, declines by 26 percent. Unfilled orders also appear to be rising.

Looking ahead, manufacturers continue to anticipate increases in shipments and new orders. In our latest survey, about two-thirds indicate that they expect increases in these categories, compared with about half in the previous survey. Fifty-nine percent of the respondents believe general business conditions in the nation will be better six months from now; this percentage rose in January after declining in each of the three previous surveys.

Manufacturers' inventories of finished goods were apparently rising in early January, a change of direction from the four previous surveys. Higher inventory levels in January as compared with December are reported by 30 percent of the respondents; 20 percent report lower levels. In the previous survey, 26 percent had reported higher levels, and 43 percent had reported lower levels. Manufacturers' inventories of materials, however, appear to have declined for the fifth consecutive survey.

Regional coal production was slightly higher in mid-December than a year ago. Coal producers are cautiously optimistic about their sales in 1987 because they are less worried about the impact of possible acid rain legislation on demand, they expect buyers to stockpile coal this year because of the threat of a strike early in 1988, and they expect to compete better with foreign coal suppliers. Increased coal production will probably not result in more jobs for coal miners, however, because of advanced mining technology.

Agriculture

A survey of agricultural specialists indicates farmers in this region should face brighter income prospects in 1987. Crop producers will probably be selling their harvests at low prices, but their production should be up substantially over the drought-reduced levels of 1986. Livestock producers will likely benefit from the low grain prices. Poultry production, a large part of the region's livestock sector, stands to benefit the most because the costs of producing poultry are especially sensitive to grain prices.

District Outlook and State and Local Government Purchases

A combination of forecasts from economists who project activity in their home states yields a forecast for moderate growth in 1987 in the District as a whole.

Regional forecasters are about evenly split between those who expect their state and local governments to increase real purchases significantly and those who expect little change in economic stimulus from their state and local governments.

SIXTH DISTRICT - ATLANTA

Economic growth in the Southeast continues at a moderate pace. Service employment gains are strong, but manufacturing job gains are weak. Holiday spending was checkered because oil patch weakness somewhat offset gains in areas benefiting from strong population and income growth. Home building's momentum may be slowing, and weakness in office building is causing overall commercial construction to shrink. Tourism continues to boost the regional economy. In agriculture, bountiful crops depressed vegetable prices and grower profits but raised revenues for citrus producers.

Employment and Industry. District labor force growth outpaced employment growth in November, and the region's unemployment rate edged upward to 8.1 percent. The unemployment rate has hovered near 8 percent since April. Job gains in services maintained the momentum of previous months as business and health services posted especially strong employment gains over the past year. Employment in the real estate sector also has continued to expand.

Manufacturing activity has registered little overall change for most sectors since September. Although textile and apparel imports were at record levels in 1986, mergers, consolidations, and the closing of inefficient mills have resulted in a more productive and competitive domestic textile industry. Mills are running at 92 percent of capacity, up 9 percent from last year, and textile employment has turned up. Labor-intensive apparel producers are bearing the brunt of import competition; apparel employment is down by 7,900 workers just in the last year.

Appliance producers report record levels of shipments due to the strong housing market. Printing and publishing companies have been adding to job rolls as savings and loans, brokerage houses, and banks offer new financial services that require checks and documentation. The transportation equipment sector continues to add jobs on the strength of auto sales and aircraft parts production. Weakness in energy drilling activity continues to batter Louisiana; employment in oil and gas extraction fell by about 22,600 workers last year.

Consumer Spending. Holiday consumer spending was sluggish in Louisiana and Mississippi, while retailers elsewhere in the region posted moderate sales gains that generally met expectations. Because of limited markdowns, most retailers expect their 1986 profit performance to be somewhat better than in 1985. Merchants reportedly were very satisfied with inventory levels at the end of their fiscal year and were generally optimistic about the outlook for 1987 despite fears that some buyers may be overextended.

District car sales rebounded sharply in December from the sluggish pace of October and November, largely in response to the well-advertised sales tax deduction advantage of purchasing a new vehicle before January 1987. Ford Motor Company's sales in the Southeast soared 45 percent in December, matching the company's strong car sales growth nationally. For all of 1986, Ford sales in the Southeast and the nation were off 3.3 and 0.2 percent from 1985 levels. Because fewer incentives are available to maintain consumer interest, the 1987 car sales outlook is uncertain.

Construction. November marked the second successive monthly decline in single-family building permits, perhaps foreshadowing a construction slowdown in the region. However, single-family houses in the medium price range of \$80,000-\$120,000 still are selling very well, and rising land costs, coupled with improved home affordability, have prompted some builders of lower-priced homes to move into the medium-priced housing market.

Although overall commercial construction is slowing, retail construction has continued at a healthy pace, spurred by continuing population in-migration. Occupancy rates are high at new shopping centers in Birmingham and Atlanta, and few lease rate concessions are being given. In Tampa, a slowdown in retail construction has helped boost occupancy rates and effective lease rates, while new store openings have caused a glut in New Orleans. Industrial construction over the past year has been strongest region-wide in the high-tech office and warehouse space segment.

Financial Services. Loan growth at large regional commercial banks continued to edge downward in November as consumer lending experienced its largest drop-off since July. Increased competition from nonbank institutions and slow economic growth have contributed to the consumer lending performance. Real estate lending has remained firm. The market for home equity loans continues to surge at about the same fast pace reported for the nation. December automobile loans undoubtedly grew sharply with the year-end acceleration of car sales.

Tourism. Travel to the Southeast, particularly by auto, remained strong in November; hotel/motel tax receipts for most of the southeastern states posted double-digit year-over-year increases. Hotels in parts of Florida experienced occupancy rates near capacity during the holiday season. Moreover, advance room bookings in Florida are up 4 to 5 percent from last year. To date, the fifteenth anniversary celebration at Disney World has been a huge success and is expected to continue to boost attendance through next October. Convention business also is posting favorable gains throughout the Southeast.

Agriculture and Mining. Regional coal production fell 15 percent in 1986 from 1985's depressed level; Alabama's production decline was much greater than Tennessee's. Strong competition from cheaper oil and natural gas led to lower coal prices, reduced production, and losses for mining operations. Oil price stability stimulated well drilling in the District even before the current price rise. The number of oil rigs operating at year's end was the highest since last May and 23 percent more than last summer.

Extremely favorable weather in late 1986 over much of Florida's vegetable-producing area has resulted in a bountiful winter harvest, especially of tomatoes. Unfortunately, vegetable prices reportedly are below production cost for many growers. Florida's citrus farmers are faring better with a larger crop than last season because prices are holding up better.

SEVENTH DISTRICT - CHICAGO

Summary

Activity has been sluggish in the Seventh District, but construction and retail sales have been surprisingly vigorous. Growth of total employment in the District continues to be less than in the U.S.; however, manufacturing employment rose recently, after an extended decline. Other steelmakers continue to benefit from the 5 1/2-month strike at USX. Auto output has been cut back modestly, from high levels. Most lines of mechanical capital goods remain weak, reflecting limited demand from both domestic buyers and overseas, including less developed countries that had been good customers. Construction in major markets in the District continues vigorous. An expected slowing in offices and apartments is not yet evident. Consumer spending improved in November and December, through a broad range of products.

Employment

Total payroll employment rose less last year in the District's five-state region, taken as a whole, than in the nation. However, Indiana outpaced the U.S., reflecting strength in construction and various services. In contrast, employment in Iowa declined. Total employment in the five-state region finally has drawn even with peaks reached in 1978-79. Employment estimates for Indiana and Wisconsin are 2 percent above previous peaks, but Illinois, Iowa, and Michigan are still below that level. Manufacturing employment turned up in the fourth quarter in the

District states, along with the nation, after trending lower for about two years. However, various employers continue to announce plant closings and new reductions in staff.

Steel

Developments in steel have been dominated by the protracted USX work stoppage begun last August 1. Other mills at the foot of Lake Michigan are running at or near capacity for steel sheet, chiefly for autos. A drop in industry shipments in November is thought by industry analysts to reflect depletion of USX's inventories built up before the strike. Unemployment benefits for eligible steel strikers are nearly exhausted. Because start-up to full operation will take 6-8 weeks for its major mills, USX must return to work soon if it is to get its share of the seasonally strong second quarter market. Local press reports hint at progress toward settlement. Steel imports continue above the Administration's market-share targets. A larger share of imports is coming from countries whose currencies have not declined versus the dollar.

Motor Vehicles

The surge in car and light truck sales at year-end, driven by tax law changes, reversed a two-month inventory buildup. GM extended holiday shutdowns at two District plants, and at several other plants, most for two extra weeks, to control stocks. Industry analysts expect car sales to fall in 1987, with domestic models accounting for most of the drop. Another Japanese motor vehicle assembly plant will be built for Fuji-Isuzu near Lafayette, Indiana. Demand for larger trucks has improved, reflecting a rise in truck freight tonnage over the past year and increased replacement

demand. Inventories of used trucks are down. The production rate for heavy trucks has risen about 8% from 1986 lows. Trucking industry adjustments in response to deregulation appear to be largely over. Like autos, purchases of mobile homes and boats were boosted in late 1986 by tax considerations.

Equipment

Demand for most capital equipment remains soft. Cutbacks in auto industry capital spending have adversely affected producers of industrial robots, machine tools, and other capital goods. Heavy construction equipment also continues weak. The top maker of earth-moving equipment plans to close 3 more plants, including one in Iowa. Demand by less developed countries for construction equipment remains low. Two leading producers of mobile hydraulic construction cranes are said to view these lines as "discontinued businesses". Most of Deere's plants have been shut by a labor dispute since August 1986. Despite the strike, stocks of farm equipment remain ample because demand is extremely weak. However, stocks of light construction equipment have become tight. Orders for railroad equipment are virtually at rock bottom. The leading locomotive producer halted output of new units indefinitely last November at its Chicago-area plant. Demand for petroleum industry equipment is very low, despite an upturn in drilling activity in the latter part of 1986. In this and other lines, demand for new equipment is held down by a market overhang of good used equipment. Demand for some types of specialized equipment, including food machinery and airline equipment, is reported slightly stronger. A steel company and a large aluminum fabricator in the District plan

substantial upgradings of their facilities. Expansion plans are likely to be raised in the chemical and paper industries because of pressures on capacity.

Nonresidential Construction

Contracts for nonresidential building in District states in 1986, through 11 months, were slightly ahead of last year, with Michigan up substantially, and the other states somewhat lower. Construction activity and bidding on commercial projects continue strong in the Chicago area. Sales of commercial and industrial buildings surged at year-end to beat the new tax law. Commercial construction activity in this area is expected to fall 10 percent or more in 1987, but shows no clear evidence yet of doing so. Some proposed office buildings have been postponed awaiting anchor tenants. However, others are being pushed ahead, including several of over 1 million square feet. Activity in December and January was boosted by mild weather. Repaving and other highway work will be abnormally low until federal funding is restored.

Residential Construction

Homes and apartment construction was up strongly in 1986 in many District centers. Conditions varied widely, however. Areas dominated by agriculture and heavy industry remain depressed. Shortages of skilled tradespeople, particularly carpenters, in the Chicago, Indianapolis, and Detroit areas have put upward pressures on builders' costs. Some analysts expect housing starts in the Chicago area to fall in 1987 due to fewer multifamily starts. A survey of landlords indicates that apartment rents in this area will rise only 3.8%, on average, in 1987, much less than would

be needed to cover the adverse effects of tax reform on cash flow from new apartments. Markets for condominiums have improved, as the excess of "investment condos" has been worked down. Home resales were up strongly in the Chicago area in 1986, and this uptrend continued into January 1987. Used home prices in the area rose an estimated 14% on average in 1986. Detroit and Milwaukee resales also rose strongly in 1986, with further growth expected in 1987. Interest rates on fixed-rate home mortgages are predominantly in the 9 to 9 1/4% range, but lenders increasingly are cutting rates below 9%. Particularly attractive fixed rates, e.g. 8 1/2%, attract lengthy waiting lists of would-be applicants. Initial rates on adjustable rates loans vary widely, with some below 7%.

Consumer Spending

District reports on department and chain store sales indicate improvement in November and December. Sales of most types of general merchandise were described as good, especially apparel, toys, and home furnishings. An Iowa producer of major home appliances is adding workers to meet strong demand. Mild weather has restrained sales of weather-related consumer products. Inventories are generally in good shape, but somewhat low for fast-moving items. Credit use continued heavy through the Christmas sales period. Price increases on imported items due to the lower dollar and trade restraints have not yet appeared at retail in most cases, but will be increasingly evident in 1987.

EIGHTH DISTRICT - ST. LOUIS

Summary

Despite an upturn by the manufacturing sector, the expansion of District employment has been sluggish in recent months and has trailed the national average. Construction, however, has grown more rapidly in the District than in the nation, led primarily by the residential sector. Preliminary reports suggest that District holiday sales were up moderately from the previous year's level. Fourth quarter lending activity at District banks was characterized by continued strong growth in commercial and real estate loans. Agricultural loan volumes and loan quality continue to decrease.

Employment

For the third consecutive month, the District's seasonally-adjusted unemployment rate was 7.7 percent in November. District nonfarm employment grew at a 2.2 percent annual rate during the three months ending November, trailing the nation's 3.0 percent rate. Employment in Tennessee grew quickly during the period (4.8 percent rate) while little change occurred in Kentucky or Missouri. The number of construction jobs in the District expanded at a rapid 7.2 percent rate for the three month period. District manufacturing employment grew at a 1.0 percent rate for the three months ending November, but was still 0.5 percent below year-ago levels. Gains in the textile/apparel and electrical equipment sectors contributed to the recent turnaround. Employment in the District transportation sector has trended downward since early 1986 with gains in aircraft manufacturing offset by losses in motor vehicle production.

Construction

For the three months ending November, the value of District residential construction contracts grew by 12.6 percent, exceeding the nation's 1.9 percent growth. Residential contracts during the period were 8.9 percent above the level of the same period last year, slightly higher than the increase nationally.

District nonresidential construction contracts grew by 6.5 percent in the September-November period, nearly matching the nation's 6.3 percent expansion. Compared with year-ago levels, however, District contracts for the period were 11.2 percent higher in contrast to a 5.7 percent decline nationally. Missouri was responsible for much of the District's construction growth with the value of residential and nonresidential contracts issued in the three-month period up 27.3 and 34.1 percent, respectively, from year-ago levels.

Consumer Spending

District retail sales followed national trends in October by falling sharply due to a drop in auto sales. Holiday sales generally met retailers' expectations of a moderate 4-6 percent rise over year-ago levels. Most retailers indicated that inventories were close to desired levels. Reports indicate that holiday sales were soft in the Little Rock area despite widespread unscheduled markdowns the week before Christmas.

Banking

Total loans outstanding at large weekly-reporting District banks grew at a 14.2 percent annual rate for the three months ending December. Fourth quarter loan activity saw a continued acceleration in commercial

and real estate lending. Commercial loans expanded at a 15.8 percent rate for the three months compared with a 3.4 percent rate for the same period last year. The St. Louis and Memphis markets have experienced strong growth in the commercial area as a result of increased purchases of loan participations rather than as a result of strong loan demand. Real estate loans grew at a 26.5 percent annual rate in the fourth quarter versus a 5.3 percent rate for the same period in 1985. Consumer lending gained momentum during the period, growing at a 26.3 percent annual rate, a rate comparable to that of the same period last year.

Agriculture

The volume of agricultural loans at District banks has followed a two-year downward trend. The volume of farm loans outstanding for the third quarter was 9.6 percent lower than one year earlier and 13.4 percent lower than two years earlier. Nationally, farm loans fell by 13.8 percent from year-ago levels. The largest decrease in the District was in Missouri where farm loans fell by 15.5 percent from the previous year. The lower levels of farm debt can be attributed to lower costs of many petroleum-based inputs such as fuel and fertilizer, lower land prices and increased scrutiny of farm loans on the part of lenders. While banks' farm loan volumes are falling, their share of farm loans is increasing because of the Farm Credit System's higher interest rates.

The quality of farm loans, as measured by nonperforming farm loans, has continued to deteriorate both in the nation and the District. Loan losses at District agricultural banks, however, have stabilized while they continue to increase at the national level.

NINTH DISTRICT--MINNEAPOLIS

Economic growth in the Ninth District may have picked up a bit late in 1986. Consumer spending was somewhat stronger than expected in December. Ongoing commercial projects have kept contractors busy. Major resource sectors have not deteriorated, and some may pick up. A few scattered bright spots have appeared in agriculture. But district states are still struggling with projected budget deficits.

Consumer Spending

A late buying rush helped keep 1986 holiday sales of general merchandise moderately above 1985's. One general retailer says its planned promotions did quite well. Another says its December sales were higher than a year earlier, with most of the increase coming during the holiday week. Both retailers were left with only normal levels of inventories. Reports from this Bank's directors and the district's newspaper editors indicate that holiday sales followed the dichotomy of weaker sales at small town, Main Street retailers and stronger sales at regional shopping centers and in larger, diversified cities.

In accord with the national trend, district sales of motor vehicles were also strong in December, as buyers rushed to take advantage of their last chance to deduct sales taxes from their federal taxable income. During the last 10 days of December, district sales of domestic manufacturers were 50.4 percent ahead of the comparable period in 1985. Due to this rush, one domestic manufacturer reports, its total sales for the whole month of December were "great," and it had low inventories of both cars and trucks left for January.

Lower interest rates have continued to fuel housing activity. Home sales in the Minneapolis/St. Paul area registered big gains late last year:

They were 23 percent higher during November and December than during those months a year ago. Homebuilders contacted in Minnesota report statewide gains during 1986, but think a recent tariff on Canadian lumber may raise home prices a bit in 1987.

Tourist spending at district ski resorts has been spotty lately, due to scattered snowfall. Fortunately, the hard-pressed Upper Peninsula of Michigan has had a strong season so far, according to a Bank director. Resorts in Montana with adequate snow have benefited from Idaho's lack of snow.

Nonresidential Construction

The geographic pattern of nonresidential construction has also been varied lately. Despite moderately high vacancy rates, contractors in the Minneapolis/St. Paul metro area have been kept busy into 1987 by commercial construction. Several large downtown office projects are under way there, and some large new office and retail complexes have been planned in the area's southern suburbs. Contractors in Duluth, Minnesota, are looking forward to over \$700 million of nonresidential construction lasting through 1988. A Pierre, South Dakota, booster notes that two-thirds of the work on its new convention center and hotel still remains. But a Montana contractor says construction sector activity is "all but nonexistent" in that state, due to a slow economy and a state budget crunch.

Resources

Resource-related industries have continued their mixed performance, although some improvement is foreseen. Wood products sectors have continued to do well. A recently established plywood operation may add 50 more workers. Gold mines in Montana and the Upper Peninsula of Michigan are one of

the few bright spots in the mining industry. But the oil and gas sector is still nearly idle, with only 28 rigs working in the district. The recent increase in crude oil prices should help that sector some.

Agriculture

Signs of stability for some farmers in some parts of the district have appeared recently. Wheat prices rose somewhat in December, and corn and soybean prices were up a bit as well. One Bank director notes that federal government payments have helped struggling Montana wheat farmers. Livestock operations have continued to be aided by low feed prices, good market prices, and mild weather. Two surveys of district agricultural bankers indicate some improvement. One of them suggests that bankers thought fourth quarter farm earnings were higher than a year earlier; the other, only that general conditions deteriorated at a slower rate in 1986 than in 1985. Better-than-expected demand materialized during some recent land sales. Still, many district farmers are still struggling, with little prospect for dramatic improvement.

Public Finance

A big cause for concern recently has been the fiscal health of state governments. District states are struggling to balance their budgets. North Dakota's governor has called for a special session to deal with the issue, and voters may be faced with increases in sales or income taxes. Montana, stung in part by lower mineral taxes, has had to plan cutbacks in its higher education spending. And Minnesota, though partly aided by higher-than-expected tax collections in December, still must plan for a potential shortfall next biennium.

TENTH DISTRICT - KANSAS CITY

Overview. Tenth District economic activity continues to improve modestly. Retail sales are moderate to strong, and auto sales for December were up due to tax law effects. Inventory levels are viewed as satisfactory to slightly high, and prices are expected to remain relatively stable. Housing activity has been helped by mild weather. The energy industry remains generally depressed. Deposits at district banks are stable to higher compared with a month earlier. Paydowns on farm loans are improved compared with a year ago.

Retail Sales. Retailers report moderate to strong increases in sales over year-ago levels, with sales of women's apparel particularly strong. Prices have changed little during the last three months and are expected to remain stable. All retailers report satisfactory inventory levels. Although some retailers are optimistic about 1987 sales, many express concern that first quarter sales might be soft.

Automobile sales. December auto sales were up from previous months, mainly due to the 1987 elimination of the sales tax deduction. Favorable credit market conditions have also helped sales. While inventory levels are generally acceptable, a few dealers report slightly high inventories. Dealers report a cautious optimism regarding future sales.

Purchasing agents. Purchasing agents in the Tenth District report stable to slightly higher input prices. Most expect relatively stable prices over the next three months. Materials are readily available, and no problems with availability or lead times are expected. Most firms are reported to be trimming inventories and generally plan to continue this policy over the near term.

Housing activity and finance. Mild weather this winter has allowed housing starts to run at or ahead of last year's levels. Multi-family housing construction has been strong in some areas, while strength in single-family construction has been more widespread. Homebuilders are optimistic for new home sales after some sluggishness in December sales. Builders report no problems with either the availability or delivery of housing materials, and materials prices are generally steady.

Most savings institutions report light savings outflows over the last twelve months due to competition for these funds, but flows have leveled off in the last month. Most expect some savings inflows in the near future. Demand for mortgage funds varies from up slightly to down moderately. Mortgage interest rates have declined slightly, and respondents expect continued modest declines in the future.

Energy. The district's energy industry has recovered only slightly from the weakness caused by the dramatic decline in oil prices in 1986. Oil prices remain well below year ago levels, although a recent OPEC agreement to restrict output has caused prices to firm somewhat. Exploration and development activity in the district has rebounded only slightly and remains generally depressed. The average weekly number of operating drilling rigs in the Tenth District increased from 272 in November to 294 in December, about half the number recorded a year earlier.

Agriculture. Throughout much of the Tenth District, paydowns on agricultural loans are satisfactory, and generally improved over last year. However, due to late harvests and wet weather, some areas in the district report delayed paydowns on 1986 agricultural loans. Late harvests have also delayed spring credit decisions for some district banks. Even so, most bankers report that very few of their current borrowers will be denied credit

this spring, due to previous action to eliminate problem credits from loan portfolios and to use of the loan guarantee program of the Farmers Home Administration.

To limit additional build-up in commodity surpluses, 1987 farm programs will allow producers to idle up to 35 percent of their acreage. Across the district, bankers generally expect a high proportion of farmers--perhaps exceeding two-thirds--to participate in the set-aside program, although few farmers have committed to date.

A mild winter, abundant winter wheat pasture, and low grain prices have encouraged many district cow-calf operators to hold more calves through the winter this year than last. Low grain prices and relatively strong hog prices have led to expectations of an expansion in hog production, but few signs of an expansion have emerged.

Banking. Total loan demand was mixed, and total deposit activity was generally constant or up, at Tenth District banks during the past month. The number of bankers reporting an increase in loan demand equaled the number of bankers reporting a decrease. The prime rate did not change at most banks, and changes in the near term are not generally expected. Consumer loan rates either fell or remained constant, and further changes in the near term are not generally expected. Demand deposits, NOW's, Super-NOW's, MMDA's, and passbook savings accounts tended to increase. IRA's, large CD's, and small time deposits generally remained constant.

ELEVENTH DISTRICT--DALLAS

The Eleventh District economy has begun a modest recovery, but overall activity is still below a year earlier. The decline in manufacturing appears to be leveling off. Drilling has rebounded somewhat. Nonresidential construction remains stable, but residential construction contract values have declined. Retail sales have been weak, but auto sales were particularly strong in December. The condition of the financial institutions still reflects the overall weakness of the region's economy. Despite some increases in December, prices of District agricultural products remain below a year earlier.

Manufacturers are noting more positive signs than at any time in the last two years, although refineries have cut production slightly in anticipation of a seasonal downturn in demand. A host of manufacturers of various energy-related durable goods report that orders have either bottomed out or that slight recoveries have begun. Construction-related durable goods producers say that declines in orders are over. For primary metals manufacturers, increases in demand from the rest of the country are offsetting declining orders from District customers, so that overall orders are unchanged. The steady pace of nonresidential construction that has continued since early in the first quarter has led to stability in the fabricated metals industry. Production of high technology goods such as instruments and electronics is stable. Orders for transportation equipment, chiefly in the area of defense-related aircraft, are up.

The drilling rig count in the District states has risen 12 percent on a seasonally adjusted basis since hitting bottom in July. Nevertheless,

the count for December was still less than half its year-earlier level. Leading indicators of drilling activity suggest that the rig count will continue to increase slowly in the near term. The seismic crew count reversed its prolonged decline and rose in both October and November. In Texas, well permit applications have also edged upward. Respondents say, however, that recent oil price increases will not result in large increases in drilling activity anytime soon.

Although nonresidential construction has stabilized after falling severely in the first half of 1986, residential construction continues to decline. While residential construction has been declining throughout most of 1986, the bulk of the reductions have generally occurred in multifamily construction. During the fourth quarter, however, the weakness has spread to single family building. Nonbuilding construction remains fairly steady.

Automobile dealers attribute strong sales during December to buyers rushing to make purchases while they could still take advantage of the deductibility of the sales tax under federal income tax law. Inventories are generally near their desired levels. Respondents report that Japanese manufacturers continue to partially offset the price effects of the appreciating yen by accepting lower profit margins. Dealers expect a slow first quarter because of continued weakness in the regional economy and changes in the tax laws.

Retail sales remain slow because of lackluster economic conditions in the District. Some retailers note that holiday sales were somewhat stronger than expected, but they say receipts were still below a year earlier. Big ticket goods, such as furniture and appliances, continue to sell very poorly. Respondents report some increases in apparel prices

stemming from new import restrictions. Retailers generally expect sluggish sales through the first quarter.

District bank performance continues to reflect the region's sluggish economic conditions. At large banks, total loans have fallen well below the year-earlier level, led by a significant year-to-year decline in business loans. Consumer loans are only slightly lower than a year earlier, while real estate loans are slightly up. Securities holdings have increased markedly, although at a somewhat slower rate than at large banks nationally. Securities holdings as a share of total large bank assets, however, have risen at a substantially faster rate in the District than nationally. Total deposits at the large banks remain far below year-earlier levels, while borrowings continue to surge and were 36 percent above last year's figure in December. The largest proportional deposit reduction has been in large time deposits. At all District banks, total deposits are also down from a year earlier.

Texas farmers received slightly higher prices in December, compared with a month earlier, but livestock and crop prices generally remain below a year earlier. Despite a dip in livestock prices in December, cattle producers continue to benefit from low feed costs and relatively strong demand for beef. Texas cotton production in 1986 is estimated to be down almost 34 percent from that of 1985, as a result of government acreage reductions and because bad weather reduced harvested acres, yields, and quality. Weather-related gross income losses to cotton producers will exceed \$50 million. These losses will primarily affect areas of west Texas where financial stress is already relatively high.

TWELFTH DISTRICT -- SAN FRANCISCO

Summary

The end of 1986 saw continued moderate growth in most parts of the Twelfth District, although some areas failed to share in the overall growth. The Christmas season was a good one for retailers in most parts of the District. Manufacturing industries continued to present a mixed picture, with strong aerospace activity but weakness in other areas including electronics. Oil and copper mining activity appear to be inching ahead, a marked improvement from the sharp downslides seen until recently in both sectors. Construction and real estate activity were affected by tax reform considerations at the end of the year, and activity in single-family home markets currently is much stronger than is multi-family or commercial activity. Financial developments reflect those in the real estate sector, with tax-related activity at the end of the year, weak multifamily and commercial lending, and continued strong mortgage activity.

Consumer Spending

The Christmas season got off to a slow start in many parts of the District, but a pickup later in the season led to satisfactory sales growth in the 5 percent range in most areas. Washington retailers reported sales growth of about 10 percent, which they attribute in part to the year-end bonuses averaging \$3000 that over 115,000 Seattle-area Boeing employees received. The gains in Washington were particularly welcome because they were achieved with few price markdowns. In sharp contrast, respondents from some communities with weak economies, such as Idaho and some agricultural areas in eastern Oregon and central California, reported flat or even declining sales and aggressive promotional activity.

Reports indicate that end-of-year auto sales were strong in most parts of the West, largely due to the elimination of sales tax deductions. Some respondents reported particularly dramatic year-end sales surges for luxury automobiles. In Oregon, which has no sales tax, little change in activity at the end of the year was reported. Most observers agree that the year-end sales spurt borrowed from next year so sales during the first few months of 1987 are expected to be slow. Evidence regarding the impact of tax reform on the purchase of other consumer durables is more mixed, as some respondents reported significant effects but most reported little discernable year-end activity.

Manufacturing

Little has changed for the West's major manufacturing sectors. Western defense contractors continue to pull in large projects, while orders for commercial aircraft also continue to roll in. These developments represent good news for Seattle and Los Angeles, as well as the many other western cities for which aerospace activity contributes to the local economy.

The electronics and semiconductor industries continue to suffer the consequences of weak demand, fierce competition, and resulting low prices. For example, one Utah company recently announced a layoff of just over 10 percent of its employees. Many companies throughout the District lost money in 1986.

Mining

At the end of 1986 some glimmers of hope began to appear for various beleaguered sectors of the mining industry. In Utah, copper companies were hiring rather than laying off workers, while in Kern County (California) some laid-off oil workers have been called back to their jobs. Moreover,

some previously shut down oil wells in Kern County now are pumping again.

Construction and Real Estate

Construction of multifamily and nonresidential building has slowed considerably in most parts of the District, and respondents agreed that overbuilding has reduced substantially the incentive to build. Some areas saw further slowing just prior to the January 1 imposition of the new tax bill, but this was not true in areas where economic conditions caused a slowdown in activity during the second half of 1986. Some observers also report that because changes in the tax law have reduced the attractiveness of real estate as an investment, real estate prices have fallen or are expected to fall in the near future.

Single-family construction activity continues to fare much better because the reductions in interest rates already seen have made housing more affordable. No tax related changes have been seen or are expected in single family home building.

Financial Sector

Reflecting changes in construction activity, the demand for construction loans dropped off sharply during the last months of 1986. However, there was a surge in tax-related deals at the end of the year as sellers raced to collect capital gains under the old tax law, which generated additional loan demand among buyers.

Mortgage lending volume fell towards the end of 1986 in some areas, but remained very strong in California. Through the first ten months of 1986, California savings and loans had closed 50 percent more mortgage loans than they had during the same period of 1985, and loan commitments for October suggested that the trend was likely to continue through the end of the year. Thus, resale activity remained strong even though housing

starts declined over the same period. In addition, some lenders report that home equity loans are becoming more popular as borrowers seek to deduct their interest payments.