

SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS

BY FEDERAL RESERVE DISTRICT

JUNE 1988

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SUMMARY*

Most Federal Reserve Districts report sustained economic growth, but some note a somewhat slower pace of growth than earlier in the year. Manufacturing remains strong in most Districts, and export demand continues to grow. Retail sales have generally been somewhat sluggish recently, and construction and real estate activity have been mixed. In the resource sector a further pickup in oil drilling has occurred, but conditions in the forest product industry vary and the lack of rainfall is a concern in crop-growing regions. Several Districts report a recent increase in loan demand.

Consumer Spending

Most Districts report that retail sales were sluggish during April and May due in part to the early Easter and unseasonable weather. Minneapolis and Richmond had favorable sales results, however, and Boston, Cleveland and San Francisco noted some improvement late in the period. Weakness in women's apparel was frequently mentioned and attributed to unpopular styles and resistance to higher prices. Despite the recent sluggishness of sales, retail inventories are generally at acceptable levels, primarily as a result of tight monitoring and generous markdowns on slow-moving items. Philadelphia described inventories as excessive, however, particularly at specialty stores. Views concerning the outlook are mixed. Those Districts with generally satisfactory sales anticipate more of the same, while those with weaker gains are less optimistic. For example, although some improvement

* Prepared at the Federal Reserve Bank of New York and based on information gathered prior to June 7, 1988.

occurred late in May, Cleveland department store executives believe the economy is in a consumer recession and expect no improvement before the fall.

Atlanta reports that autos are selling well, while San Francisco has had strong sales of used cars but only moderate new car results. Cleveland and Kansas City found auto sales to be steady but not robust, while Dallas had mixed results.

Manufacturing

Manufacturing activity remains strong in most Districts though Dallas and Atlanta report a slowing of new orders in some industries. Boston, Chicago, and Cleveland cite export demand as a factor in their manufacturing strength and Philadelphia notes that a year-long uptrend in manufacturing employment has continued. Chicago and Cleveland report sustained strength in the steel industry with Cleveland noting that the Great Lakes shipping industry is reportedly getting close to its cargo-handling capacity. San Francisco states that a number of industries are experiencing capacity constraints but that plans to expand are cautious. Several Districts mentioned rising input prices, particularly for paper, petrochemicals and steel, and Philadelphia reports an increase in factory wages resulting from a shortage of basic production workers. While Boston and Kansas City find that materials are still generally available, San Francisco reports shortages of raw materials, farm equipment and heavy machinery.

Boston and Richmond report that factory inventories are at satisfactory levels, and Kansas City states that firms plan no inventory changes in the next six months. However, Atlanta notes, with new orders falling, textile producers find that their inventories are building. Most

other manufacturers in Atlanta, and especially producers of paper and chemicals, remain strong. Factory employment levels are satisfactory or rising in Boston, Cleveland, Philadelphia and Richmond, but St. Louis reports that, except for transportation equipment, all major manufacturing sectors have reduced employment recently.

Construction and Real Estate

Construction and real estate activity has varied among Districts. While residential construction is relatively strong in Chicago, Minneapolis, and Richmond, most other Districts report some weakening. Boston notes, however, that the prospect of rising interest rates may stimulate some activity in its currently slowing residential real estate market, and Kansas City states that most observers anticipate an increase in housing starts there. Commercial construction shows a more consistent pattern. Chicago and New York note a substantial amount of new office building underway and Atlanta and St. Louis report an expansion in nonresidential construction as well. Plans for several big projects have recently been announced in the Minneapolis District, and Dallas reports some recent stability in its nonresidential sector though at a low level of activity.

Agriculture and Natural Resources

Districts reporting on agriculture present a mixed picture. The lack of rainfall is a concern in all of the crop-growing regions, but only Dallas and St. Louis spoke of reduced yields as a major threat thus far. Atlanta and Richmond have good crop conditions and Chicago, though noting a surge in crop prices as a result of the drought, states that the extent of irreversible crop damage is believed small at this time. Cattlemen in the San Francisco and Atlanta Districts are getting sharply higher prices and enjoying substantial

income gains. However, livestock producers in Dallas and Richmond expect lower profit margins due to falling demand and increased feed costs.

Oil production has stabilized in Atlanta and Kansas City and drilling activity in both Dallas and Kansas City is above year-earlier levels. While Minneapolis describes a booming paper mill industry, Atlanta reports that prices for lumber and building products have declined, and San Francisco also notes some slowing in its forest products industry.

Financial Developments

More than half the Districts mention an increase in loan demand. Philadelphia notes an acceleration in business loans and strong growth in real estate lending. An increase in real estate loans was also reported in the Atlanta, Cleveland, Kansas City and St. Louis Districts and Richmond, Kansas City and St. Louis note stronger demand for business loans as well. Dallas states that the rates of decline in assets and liabilities at its large banks have moderated. New York and San Francisco note that higher interest rates are causing a shift to adjustable rate mortgages.

FIRST DISTRICT - BOSTON

Manufacturers in the First District report that business is strong, in part because of a pickup in exports. Retailers experienced a slowdown in May but attribute the pause to poor weather rather than to any slackening in underlying consumer demand. Rising costs are a concern: rapid increases in selected materials prices have pinched manufacturers and rising payroll costs may force some retail price increases. Capital spending plans are more modest than in recent years, but both retailers and manufacturers are optimistic about the second half of the year.

Retail

The First District retailers surveyed reported slower sales in May. However, they universally blamed the softness on raw weather during the first three weeks. Materials for outdoor projects and seasonal merchandise moved especially slowly. Bright sunshine on the Memorial Day weekend, however, brought spirited shopping. Most retailers are thus confident that they will recoup their lost sales.

Supplier prices are basically flat, although imported goods and plastics show some increases. Far more troublesome are labor costs. While New England's tight labor market is driving up wages, insurance expenses (such as Social Security, workmen's compensation, and medical coverage) which reflect national trends, are reportedly rising even faster.

Profits are showing signs of slippage as a result of softer sales and rising expenses. Nonetheless, expansion plans are proceeding, though at a slower pace than in 1987.

Manufacturing

Most First District manufacturers report that business is strong, with shipments generally up 8 to 25 percent and orders up 8 to 15 percent compared to a year ago. (As exceptions, one machine tool maker's sales have doubled while business is flat at two fabricated metals firms.) Sales of packaging materials and sales to customers in computers and electronics were described as particularly buoyant. Moreover, for the first time in months, a majority of contacts mentioned increased exports. Exports of specialty textiles, hobby equipment, electronics and instruments rose significantly. By contrast, firms serving the auto industry and the Department of Defense have mixed views about the strength of these markets. In addition, several respondents mentioned signs of caution among their customers: one firm is being asked to hold inventories for its customers; another said customers are taking a "just-in-time approach" to adding capacity; and a third is experiencing "continuing deferrals" of big ticket items.

Almost without exception, First District manufacturers indicate that certain materials prices are rising rapidly, even "alarmingly." They mentioned paper, petro-chemicals, steel, copper and nickel. Nickel prices have doubled since February. No one expressed any concern about the availability of these materials, however. Only a minority of respondents have been able to pass these price increases on to their customers. Most report that their own prices are up 1 to 2.5 percent.

Inventory and employment levels are broadly satisfactory at First District firms. Only a few contacts indicate that inventories are uncomfortably high. Employment is generally stable or declining slightly,

reflecting productivity increases. While most respondents report "normal" wage increases, a small number think wage pressures may be developing.

Most manufacturers contacted are not engaged in expansive capital spending programs. The majority had made major capital expenditures over the last several years and have adequate capacity.

The outlook for 1988 remains very positive. Most First District firms expect a strong, even a "banner" year, although a manufacturer of discretionary consumer goods expects a "rough retail year." Two respondents expect a recession in 1989, but most are reserving judgment until after the election.

Residential Real Estate

First District residential real estate sales were unusually slow this spring. Some realtors report that activity rose significantly at the end of May but others have seen no change. No contacts are experiencing more activity now than last year at this time. The prospect of rising interest rates, however, may encourage some acceleration of sales. Preferences for small versus large homes is mixed, but buyers appear to be far more interested in houses than in condominiums.

Outlook

The New England Economic Project (NEEP), a nonprofit organization comprising businesses, government agencies and educational institutions, held its semi-annual outlook conference early in June. The NEEP forecasts for the six New England states call for nonagricultural employment in the region to increase somewhat more slowly in 1988, 1989, and 1990 than the

2.6 percent growth rate experienced in 1987. Growth will be more balanced than in the recent past; manufacturing will contribute positively to projected employment gains through the beginning of 1990 but nonmanufacturing industries will still account for most of the additional jobs. Unemployment rates may rise slightly, but will remain almost 2 percentage points below the national average, according to the forecasts.

SECOND DISTRICT--NEW YORK

Economic activity in the Second District has continued mixed. Overall business conditions were stable to improved and office leasing activity was moderate to good. Retail spending remained sluggish, however, and demand for new homes varied somewhat among areas. Small-and medium-sized banks raised their mortgage rates following the May 11 prime rate increase.

Consumer Spending

Retail spending in the Second District continued somewhat sluggish in recent weeks with April sales ranging from below year-earlier levels to moderately above. The earlier Easter this year was noted as one factor in the slow April performance, but partial results for May were disappointing as well. As one retailer commented: "Customers just aren't spending and we really don't know why". Women's apparel sales have remained weak and the gains which occurred in other lines were not particularly strong.

Year-to-year changes at District stores in April ranged from -6.9 percent to +3.3 percent, results which were "well below" to "just about on" plan. Partial data for May show some over-the-year gains but smaller than were expected. Inventories were generally at comfortable levels, however, due to close monitoring and aggressive markdowns, though one respondent reported an undesired buildup.

Business Activity

Economic conditions in the Second District have been stable to moderately improved in recent weeks. The proportion of Buffalo purchasing

managers reporting higher new orders rose by 13 percentage points in May while the latest Rochester survey indicated little overall change. In both areas the percentage of surveyed firms with lower inventories has declined.

As was true nationally, unemployment rates in the District were somewhat higher in May. However, rates of 4.2 percent in New York and 3.7 percent in New Jersey represented May-to-May declines of 0.7 and 0.4 percentage point, respectively. While May data for New York City are not yet available, it appears that, through April, the employment declines resulting from the stock market crash were offset by job growth in other sectors.

Several recent announcements point to continuing expansion in the District's economy. The Defense Department awarded a \$236 million contract to a team headed by General Electric for the development and initial deployment of the "Star Wars" defenses. In addition, a number of firms are planning substantial growth and modernization here. These include firms making products ranging from radial tires and fiberglass insulation to aerospace and telecommunication equipment.

Residential Construction and Real Estate

Residential construction activity has varied within the District since the last report. In some areas the prime homebuilding season began strongly with little or no slowdown from the year-earlier pace, while in others, builders are busy but activity has declined to a more normal level compared with the past few years. Things remain sluggish in some areas, however, particularly where home prices are quite high and where layoffs resulting from the Wall Street cutbacks have occurred. The rise in mortgage rates was reported to have had little impact on homebuilding thus far.

Developments in the District's commercial real estate market have been mixed. Office vacancy rates have declined in areas such as northern New

Jersey and Long Island while remaining at virtually unchanged high levels in Westchester and Fairfield counties. Leasing activity has generally been moderate to good, particularly for buildings in desirable locations and of good design. The major exception is downtown Manhattan where leasing activity continues weak. Given the large number of buildings currently under construction in midtown Manhattan and northern New Jersey, however, there is concern that vacancy rates will rise as this new space becomes available.

Financial Developments

Small-and medium-sized banks in the Second District survey generally raised their mortgage rates in response to the May 11 increase in the prime rate. However, rate increases on non-prime based business and consumer loans have been more spotty. Most of the bankers expect further rate increases during the second half of 1988, though none predicted sharp rises. A few of the surveyed officers believe that interest rates have already reached their 1988 highs and should stabilize at current levels. While many analysts link rising interest rates to inflation fears, most of our respondents did not expect a surge in inflation though nearly all believe their local economy is strong. The rise in mortgage rates has reduced mortgage activity somewhat, but the response to date has not been pronounced. Mortgage activity in the New York City metropolitan area remains more sluggish than in other parts of the District. With the rise in interest rates, many mortgage officers have noted a shift back to adjustable rate mortgages. One banker said that those with caps on future rate increases were particularly popular. Business in home equity loans, usually priced separately from mortgages, continues to be brisk.

THIRD DISTRICT - PHILADELPHIA

The Third District economy is continuing to grow in June, although some softness has developed in the consumer sector. Manufacturing activity remained on an upward trend as the month began, with continuing gains in employment noted. Retail sales, however, have been only steady in recent weeks, and retailers say the year-to-year comparison is also flat. Bankers report real estate lending growing at a strong pace, an acceleration in business lending, and slow but steady growth in consumer lending.

The consensus forecast in the Third District business community is for a continuation of current trends. Manufacturers predict more growth over the next six months, at around the current pace, but they say cost and wage pressures will mount. Retailers expect summer doldrums that might extend into fall. Bankers forecast growth in commercial and industrial loans in line with overall economic growth, but they say real estate lending may slacken as commercial development in the region tapers off.

MANUFACTURING

The Third District industrial sector continues to advance, according to preliminary results of the June Business Outlook Survey. Among local manufacturers contacted early in the month, 26 percent said overall business was moving up while only 7 percent said it was slower. Makers of durable goods reported stronger business than did nondurable goods manufacturers, with the latter operating at a steady pace. On balance, among all surveyed firms, most measures of business conditions showed improvement: new orders and shipments were rising and order backlogs were moving up.

Factory employment is continuing on its year-long upward trend this month. Manufacturers say the labor market for basic production workers is tight, but there is no shortage of skilled labor; thus, while they have been able to hire new skilled workers without boosting wages, they have been raising wages at the lower end of the pay scales. Large firms said that while labor market conditions in general have not been pressuring their wage bills, contract COLAs are being triggered by inflation and are likely to increase later this year and next, unless month-to-month increases in the CPI subside.

A negative note in the most recent survey is the continuing increase in reports of higher input costs. With 65 percent of surveyed firms reporting increases in the prices of purchased goods, this index is registering its highest reading since May 1981. Survey respondents expect further increases in costs: 83 percent of the companies polled in early June predict input costs will rise during the second half of the year.

Forecasting general business conditions for the next six months, local firms generally foresee further growth at around the current pace, with gains in both shipments and orders. Overall, area industrial companies are planning moderate increases in employment and capital spending between now and year-end.

RETAIL

Third District retailers contacted in early June said sales in May were only even with May of last year, in real terms, and the trend in recent weeks remains flat. Generally lackluster sales have backed up inventories to excessive levels, particularly at specialty stores, according to local merchants, and some describe stocks as significantly higher than they should be. Sales of home furnishings are healthy, but women's apparel sales remain weak, and sales of seasonal items have been poorer than expected, which merchants attribute to cool, rainy weather. Discounting and promotional efforts to move

both lines are widespread. Most retailers expect sales in general to remain flat over the summer, and they are less than optimistic for the balance of the year. Many stores have cut back on orders for fall merchandise.

Despite the slackening trend in sales, store officials say they are having difficulty maintaining adequate staffing levels. With a shortage of qualified applicants for store jobs, wage and training costs are rising.

In order to maintain profit margins in the face of rising dollar costs of imported merchandise, many stores are turning to domestic suppliers, especially for apparel. In other efforts to reduce costs, several retailers plan to close marginal and money-losing stores in the area.

FINANCE

Loan growth at major Third District banks has been running at a fairly steady pace of about 10 percent (annual rate) in the last few months, and bankers contacted in June say growth will probably accelerate in response to an increase in business loan demand lately. According to bank lending officers, some of this demand represents an attempt by borrowers to lock in fixed-rate funds in anticipation of further hikes in the prime rate; but bankers believe most of the recent spurt in business loan demand stems from healthy growth in the regional and national economies. Lending to consumers is growing steadily, according to area bankers, but at a slower rate than other credit categories.

Real estate lending continues to advance strongly, but bankers say this growth may taper off soon. With growing softness in commercial real estate markets, permanent financing for projects is becoming more difficult to obtain, and area banks generally do not extend loans to developers unless such financing has already been arranged.

FOURTH DISTRICT - CLEVELAND

Summary

Economic activity in the Fourth District has changed little from the last report. The region's economy continues to benefit from the export boom. Labor market indicators are uniformly positive, with the unemployment rate in Ohio resuming its downward trend over the last two months to 6.2 percent in May. Production, employment, and orders are generally up at manufacturing firms. Although department-store sales remain sluggish, auto sales continue at a steady pace. Banks report relatively strong growth in consumer installment and real estate lending.

Retail Sales

Department-store sales in the Fourth District continue to be sluggish, and are falling short of targets. Although sales improved somewhat in late May, it is unclear whether that reflected a true pickup in demand or just a temporary response to increased markdowns. Some retailers say that sluggish sales reflect unpopular styles, especially in women's wear, rather than consumer unwillingness to spend.

Higher prices for apparel have also hurt sales. Merchants don't expect much more strength in sales this summer, although some expect stronger results in the fall. There is a sense among department-store executives that they are in a consumer recession, and they are puzzled by reports of strong growth of overall personal consumption expenditure. Department-store inventories are generally at comfortable levels. However, some contacts complain that they

have had to offer unusually generous markdowns to avoid an inventory buildup, contributing to weak earnings.

Auto sales have been steady but not robust. Dealers comment that financing and rebate incentives seem to have lost their power to stimulate showroom traffic and sales. Several dealers report that an unusually high number of inquiries have recently been coming from qualified buyers (those who can afford to buy). Dealers do not sense any tendency among consumers to cut down on their spending. Dealer inventories are at comfortable 55- to 60-day levels, with occasional shortages of popular models. One import dealer reports being down to a 10-day supply.

Labor Markets

Labor market indicators in the region were uniformly positive in May. In April and May, the trend toward narrowing the gap between the national unemployment rate and the Ohio rate was reestablished. The seasonally adjusted unemployment rate for Ohio fell from 7.7 percent in March to 6.3 percent in April and 6.2 percent in May. The decreases came primarily from fewer unemployed workers, rather than from employment growth.

Nevertheless, May surveys of manufacturing and nonmanufacturing companies in Cleveland, Cincinnati, and Pittsburgh metropolitan areas consistently reflect an increase in workforce expansions and/or a decrease in employment reductions. For all three areas, the number of surveyed firms that reported employment expansion outnumbered those that reported a contracting workforce. Cleveland-area factories reported hiring additional workers to reduce overtime, adding second shifts, and adding salaried personnel. The Cleveland help-wanted index (which tends to lead unemployment changes by three to six months) was also up in recent months.

Manufacturing

The export boom continues to boost economic activity in the District. Surveys by Cleveland and Cincinnati purchasing managers indicate that businesses continue to experience a favorable economic climate. Production, employment, and orders are all up, and few see a recession occurring in the rest of 1988. The groups report problems in obtaining a variety of materials and supplies, including aluminum, bearings, electric motors, paper products, and ethylene-based chemicals.

Raw steel production in Ohio rose 5 percent from March to April, as the steel industry continues to enjoy strong demand for its products. In the three-month period from March to May, raw steel production in the Youngstown, Pittsburgh, and Lake Erie regions rose almost 6.5 percent over the same three-month period a year ago. Purchasing managers in Cleveland and Cincinnati report price increases and shortages in stainless steel, steel plate, and sheet steel.

Another positive sign of the strong regional economy is the rising number of freighters sailing the Great Lakes. Eleven more freighters are now flying the U.S. flag than at this time a year ago. These freighters are primarily used to haul iron ore, stone, cement, sand, and other construction materials. Sources report that the U.S. lake shipping industry is getting close to its cargo-handling capacity, particularly in iron ore.

Banking

Loan growth has been moderate at District banks. Total loans outstanding at large banks grew at a 2.2 percent annual rate between the end of March and mid-May. After expanding at an annual pace of 22 percent during the first

quarter, business loan growth has been relatively flat so far in the second quarter. In contrast, real estate and consumer lending has picked up even though loan rates have increased. Real estate loans outstanding grew at an annual rate of more than 20 percent, and consumer installment loans outstanding rose at an annual clip of 19 percent.

FIFTH DISTRICT-RICHMOND

Overview

The Fifth District economy continued to grow in May. Retail sales increased at about the same pace as in March and April. Tourism was stronger than usual this spring and is expected to remain high through the summer. Manufacturing activity increased in May, although shipments rose less rapidly than earlier in the year. Exports at major District ports increased faster than imports in May, as was the case in March and April. Housing remained robust. Generally, District farmers are enjoying good growing conditions. At District banks, commercial and industrial loans rose sharply in May, and real estate and consumer loans also increased.

Manufacturers and retailers expect inflation to rise in the coming months. They also look for improvement in the U.S. trade balance. Most District bankers expect strong to moderate economic growth.

Consumer Spending and Tourism

District retailers responding to our regular mail survey reported increased activity in the ten business days ended June 3, compared with the previous ten days. Half of the respondents reported increases in sales, while only 16 percent reported declines. Twenty-six percent of the respondents said their inventories declined compared with 60 percent who said their inventories did not change.

Over 50 percent of the retail respondents expect their sales to increase in the next six months. Retailers look for inventories to decline over the same period.

Most District resorts and hotels contacted by telephone reported spring activity was higher and summer bookings were running well ahead of last year.

About one-fourth of our contacts in the tourist business expect the lower foreign exchange value of the dollar to encourage more U.S. vacations and boost their revenues.

Manufacturing

Manufacturing activity expanded further in May, according to our regular mail survey. New orders, backlogs of orders, employment, and the length of the workweek increased at about the same pace as in March, but the rate of increase in shipments apparently slowed. Forty-seven percent of the respondents reported increased shipments, down from 54 percent in the previous survey. Reports of reduced shipments increased to 12 percent in this survey from 10 percent in the previous survey. Inventories of finished goods were reported generally unchanged. About one-third of our respondents reported increased inventories of materials and about one-half percent reported no change.

Prices in the manufacturing sector continued to rise. Twenty-two percent of the respondents said they had raised the prices of finished products, and 70 percent reported higher prices for raw materials, compared with almost no respondents who reported declines. Most respondents said they expect further price increases in the next six months. One of our contacts said that because of the lower dollar, domestic producers of plastic resins and other petrochemical products are exporting more, which is reducing supplies and raising prices for these materials in the United States.

District manufacturers expect their businesses to expand further in the next six months. About 40 percent of the respondents believe their shipments and new orders will rise, compared with about 15 percent who anticipate declines. The majority of producers do not plan to change their inventory levels in the next six months.

Inflation and Trade Expectations

We asked manufacturers and retailers in the District to indicate their expectations about rates of increase in U.S. prices, wages, exports, and imports in the next six months as compared with the last six months. The results are summarized in the table below.

	<u>Respondents Expecting Rate of Increase to</u>		
	<u>Rise</u>	<u>Slow</u>	<u>Not Change</u>
Prices	40%	10%	50%
Wages	23%	16%	61%
Exports	56%	19%	25%
Imports	9%	52%	39%

One of our manufacturing contacts said that inflation worries were exaggerated. Wages were in check, he said, and only a few agricultural commodity prices had risen recently because of drought reports.

Port Activity

Representatives from the three major District ports--Baltimore, Hampton Roads (Norfolk), and Charleston--reported moderate increases in export shipments in May. Import shipments in May were reported lower at Hampton Roads and Charleston, but higher at Baltimore. These contacts anticipate further increases in net exports during the next six months.

Housing

The District housing market remained relatively robust in May according to a survey of realtors and builders. The pace of new home sales apparently increased from early spring; none of our contacts reported overall declines in May, although one-fourth reported declines in speculative building.

Agriculture

Growing conditions for crops have been excellent over much of the District. However, some dry spots were reported in the Carolinas and one contact said soybean planting had come to a halt in the northern part of South

Carolina because of dry weather. Scattered heavy rains and hail caused some localized crop damage and planting delays in other parts of the District.

Across the District, farmers are holding large acreages out of production to qualify for government price supports. One crop producer said that so much land was out of production that he could not see any way that farmers nationwide could produce a surplus of soybeans. Higher market prices, however, could cause some of the acreage to be planted late. Livestock producers anticipate lower profit margins this year as feed costs rise.

Financial

Most major District banks contacted in our telephone survey indicated increased loan activity in May. According to our respondents, increases in consumer lending were mainly in auto loans, which respondents attributed to the decline in loans by automobile finance companies. Commercial, industrial, and real estate loans grew substantially in the past month according to most bankers, but some West Virginia respondents reported declines.

The majority of bankers contacted anticipate strong to moderate economic growth in their areas. They expect the continued growth in residential and commercial building to raise loan demand. Most believe interest rates will rise slightly over the next four months.

Small Business

Some financial institutions have reportedly become less willing to make small commercial loans. According to one report, small businesses are increasingly using consumer credit for their credit needs.

SIXTH DISTRICT - ATLANTA

The growth of the regional economy has slowed a bit since the beginning of the year. While most manufacturing industries exhibit strong growth, business services and trade are slackening. With the exception of autos, retail sales remain lackluster. Although residential construction continues to sag, nonresidential construction has picked up. Bank loan activity in May varied across the District but in most states modest growth occurred. Higher crop prices should help farmers prosper, however, the potential for yield losses from dry weather is increasing.

Employment and Industry Business activity in the region has slowed somewhat since the last reporting period. Employment growth in some sectors has cooled while others continue to operate at capacity levels. New orders are falling for textile producers and inventories are building. Business services as well as trade are off the pace of previous months due in part to slower consumer spending.

In contrast, most manufacturing, and particularly companies producing paper and chemicals, continue to report strong business activity. In the paper industry, price increases were noted in both kraft sheet from which corrugated shipping containers are manufactured and in chemicals used in the paper production process.

Consumer Spending Retailers in the region report that disappointing spring sales continued in May. Memorial Day weekend sales ranged from poor in Mississippi to good in Florida. However, most areas found sales mediocre and at about the same dollar level as last May. Inventories remain at acceptable levels.

Car sales continued to be helped by extended manufacturers incentives and intense competition among dealers through mid-May. Domestic car and truck sales in particular are benefitting from the recent surge in buying. The first quarter's new motor vehicle registrations in the Southeast rose 13 percent over 1987's level. This performance represents a marked improvement over the sluggish sales pace registered in the first quarter of 1987.

Construction Home sales in the Sixth District were mixed throughout May as mortgage interest rates turned up. Residential construction value in the region was down 13 percent through April, well below the 8 percent decline for the nation. Construction is expected to decline further in the months ahead. Alabama and Florida report that home sales have been strong as mortgage interest rates have bottomed out. Tennessee's housing market has improved steadily in 1988, but still is down from last year's pace. In Louisiana and Mississippi, home sales remain depressed.

In contrast, nonresidential construction has regained momentum in the Southeast this spring, posting a 3 percent rise in construction value over the first four months of 1987. Much of the District's increase has been in Georgia, which was boosted by Atlanta's 64 percent increase through April. Tennessee's construction has also surged ahead of last year's pace. Downtown office construction in Jacksonville and in New Orleans have led the way for their respective states over the last two months.

Financial Services Large banks in the Sixth District experienced flat to moderate growth in loans during May. Business loans were sluggish while real estate loans were strong. All contacts agreed that it is too early to discern the impact of higher interest rates on loan demand.

Bankers throughout Florida agree that loan growth was flat in May, but lenders in Georgia reported steady growth in total loan volume. Consumer loans accounted for the majority of Georgia's loan growth. Louisiana is the only state to register strength in business loans. Other states generally reported flat or declining trends in both business and real estate lending.

Tourism Tourism was slow in May but rapid increases were expected by mid-June. Foreign visitors have been flocking to the Southeast, especially Orlando, Daytona Beach, Miami, and New Orleans. Reasons for this include the weak dollar, direct marketing abroad, and increased international flights directly to Miami and Orlando. Despite the increased traffic, hotel occupancy has either been holding steady or declining throughout the Southeast partially due to the fact that more travelers are staying with

family and friends while on vacation. National Park attendance is already up 4 percent this year and is expected to climb even more.

Agriculture, Forestry, and Mining Pork and egg producers are experiencing sharp declines in revenue as a result of weak prices. Cattlemen, however, are enjoying substantial gains from sharply higher prices. Crops are in good condition at present but soil moisture levels are perilously low. Further dry weather will quickly reduce yields. Crop prices are much higher than a year ago and could increase even more if weather damage occurs.

Lumber and building products industries are experiencing weaker prices due to the decline in housing starts in the Southeast. One bright spot, however, is a further decline in competition from Canadian lumber as price differences widen.

Oil production stabilized in recent weeks after falling slowly throughout the winter. Nonetheless, production remains down 5 percent from the same period last year. Conditions in the coal industry are stable; coal production is up 4 percent over last year thus far.

SEVENTH DISTRICT--CHICAGO

Summary. Expansion is continuing in the Seventh District, paced by strong exports and rising capital spending. Total employment growth in the District states so far this year has been in line with the nation. Purchasing managers in Chicago, Indianapolis, and Milwaukee reported strength in activity at their companies. The vigorous pace of activity in the industrial sector reflects the rise in demand for equipment. Orders for steel have been boosted by the expanding equipment markets as well as strength in motor vehicles and an upturn in industrial construction. Office construction, at a high level, may slow somewhat, and further slippage is expected in apartment building. Retail sales have been mixed. Conditions in the farm sector have continued the upturn that began last year, but persistence of a lack of rainfall could cause considerable damage to crops.

Manufacturing. Industrial firms in the District continue to report vigorous demand, in part reflecting the lower dollar and stronger capital spending. Manufacturers indicate sizable gains in shipments abroad, and some are exporting products previously sold entirely to the domestic market. This increased business is boosting demand at firms providing related services such as freight forwarders, foreign trade consultants, and banks. Makers of components used in a wide range of machinery indicate sizable increases in sales, ranging from 10 percent to 30 percent above a year earlier for various lines. Purchasers placed on allocation are reported to be double ordering, as are others concerned about problems with availability of materials, parts, and supplies. Customer inventories have been increased to guard against problems in obtaining supplies. Steel mills in the District remain at capacity. Strength in steel orders--booked into next year according to a source at one

modern mill--reflects the upward adjustment in auto production plans, the record pace of truck output, stronger markets for industrial and farm equipment, an upturn in construction work on factories, and a continued high level of work on other types of construction.

Motor Vehicles. Sales of motor vehicles continued at a healthy pace in May. Domestic trucks have shown particularly strong gains, and appear headed for a record year. Two pickup truck assembly plants in Michigan are adding second shifts. Some heavy truck makers are not scheduling vacation shutdowns this summer. A Michigan auto assembly plant is adding a second shift to help meet demand for cars, and the scheduled closing of the Kenosha, Wisconsin, plant is being deferred until early 1989. Planned auto assemblies through September are above year-earlier levels.

Construction. The pace of construction activity in the District, overall, is expected to remain relatively high in 1988, but appears to be slowing. Contracts for construction of nonresidential buildings in District states through April were 2 percent lower (in square feet) than a year earlier, and residential contracts were 19 percent lower. The decline in housing was sharpest early in the year, reflecting unseasonably strong construction starts in early 1987. For all of 1988, starts on homes in the Chicago area are projected to be near the 1987 pace, but apartments will be lower. With few completions expected, construction activity on large Chicago-area office buildings already underway will continue at a strong pace, but there may be a lull in new starts. The mix of nonresidential building construction is shifting toward industrial structures, including warehouses, though hotel construction in downtown Chicago is also strong with several additional major hotels in the planning stage.

Retailing. Stores in the District report mixed sales performance in recent months. Sales at a large general merchandise retailer were excellent in the first week of June after only a small year-over-year rise, on a same-store basis, in May. Another general merchandiser reported somewhat slower sales in May than a year earlier. Lackluster May sales were attributed partly to weather. A survey of over 200 Illinois retail stores showed sales in April only fractionally higher than a year earlier, attributed to the early Easter, and February-April was about 2 percent above last year. Specialty stores were weakest, both in April and the latest three months. A large retailer reports increasing upward price pressures from suppliers, especially on plastics. A maker of large home appliances expects sales this year to be only slightly below the 1987 record, but is concerned about 1989.

Agriculture. Improvement in the agricultural sector of the District is continuing this year, helped by government programs. Farmland values have been rising, after a protracted decline. Equipment purchases have increased, from low level. The amount of problem farm loans has declined considerably in the wake of improved sector earnings.

Drought conditions throughout much of the Midwest have triggered a surge in crop prices. To date, the extent of irreversible crop damage is believed to be small. But the risk of extensive crop damage has been heightened considerably if timely rains are not forthcoming through mid-August. The recovery underway in the farm sector would suffer a substantial setback in areas hard-hit by a drought.

EIGHTH DISTRICT - ST. LOUIS

Summary

The Eighth District economy is slightly weaker than in recent reports. After several months of rapid growth, employment in most sectors declined. Construction activity expanded moderately, despite declines in residential building. District manufacturers reported moderate-to-sharp increases in input prices, but no strong wage pressures. Bank lending continues to be slow, particularly in the consumer and real estate areas. Crops face a shortage of rain at a critical point in their growth.

Employment

District nonfarm employment fell at a 2.6 percent annual rate during March and April after growing at a 8.4 percent pace between November and February. This trend was evident in most District states and industrial sectors. Manufacturing employment declined at a 4.3 percent rate following a 5.6 percent rate of expansion during the same periods. Except for the transportation equipment sector, all major manufacturing sectors reduced employment between February and April. This reduction was particularly severe among textile and apparel producers, who enjoyed moderate growth in 1987.

Manufacturing

District manufacturers generally report higher input prices, but no strong wage pressures. The largest price increases were reported by a

shoe manufacturer, who is faced with leather prices 15 percent higher than a year earlier, and a fertilizer supplier, whose input prices were up 18 percent from a year earlier. Both manufacturers have sharply raised their prices.

The reasons for the lack of wage pressures varied. Some District businesses, located in rural areas, still have abundant supplies of surplus labor, reflected in county unemployment figures well above 10 percent. In addition, expanded automation has allowed some manufacturers to increase output substantially without hiring many new workers. A major appliance maker reported that wage pressures are not currently a problem, but could be in the fall, when union labor contracts are renegotiated.

Construction

District construction activity has expanded in recent months, though more slowly than the national average. The value of building contracts issued in the District rose 2.8 percent in the three months through April compared with a 4.1 percent national gain. While contracts for nonresidential buildings rose more rapidly in the District than in the nation (11.5 vs. -1.4 percent), District residential growth was weaker (-3.4 vs. 8.4 percent). Only Tennessee, among the District states, showed an increase in the residential sector. Compared with a year earlier, District residential contracts in the February-April period were down 9.7 percent. In the St. Louis area, residential building contracts issued this year are down 6 percent from a year earlier, with a sharp drop-off in multifamily construction.

Banking

For the three months ending in May, total loans at large, weekly reporting District banks grew at a 6.3 percent annual rate, down from a 7.1 percent rate for the same period last year. Consumer and real estate lending, in particular, have fallen considerably. Consumer loans declined at a 0.6 percent annual rate, after expanding at an 8.2 percent for the same three-month period a year ago. Real estate loans grew at a 7.8 percent rate, well behind the 20.6 percent rate for the same March - May period last year.

Agriculture

Dry weather has begun to threaten crops throughout the District as they enter a critical growth stage. Rainfall in April and May was the lowest ever recorded in many regions. Farmers in northern Missouri have been allowed to graze cattle on acreage previously kept out of production by the price support programs. Other states anticipate taking the same action if dry conditions persist. Projections for the upcoming wheat harvest have been scaled back because of dry conditions. Many speculate that continued bad weather could push soybean prices to \$10/bushel, double the 1987 price. Although the long-term outlook calls for more hot and dry weather, good rains in the coming weeks could lead to large crops because of the early planting progress.

Farm loan performance at District agricultural banks improved significantly in the first quarter of this year compared with the same period in the last two years. The percentage of nonperforming agricultural loans fell from 9 percent in the first quarter of 1987 to 6 percent this year. Most District states showed comparable improvement.

NINTH DISTRICT - MINNEAPOLIS

Economic trends in the Ninth District continued to be favorable this spring. Unemployment declined again, and consumer spending held up surprisingly well. Some important new construction projects were announced. The forest products and mining sectors benefited from increased demand. Except for excessive dryness, agricultural conditions remained stable.

Labor Markets

Labor market conditions remained favorable in the last few months. Minnesota's unemployment rate dipped to 3.8 percent in April, its lowest rate in more than eight years. The state's initial unemployment claims were about 3 percentage points lower this April than in April 1987. In Montana and North Dakota, unemployment rates were also estimated to have fallen significantly in April. For South Dakota, March data show that job growth continued, with manufacturing leading all other industries.

Consumer Spending

Retail spending on general merchandise has borne up well recently. One retail chain reports that its department stores' sales in the district were 9 percent higher this May than last. Another chain reports that Memorial Day sales were brisk and that its sales were up 14 percent so far this year. This chain is continuing to remodel some stores while building additions to others. Contrary to experience over the last few years, sales growth has not been confined to just major metropolitan areas. A Bank director notes that retail sales were holding up well in most North Dakota cities, with spending by Canadian visitors helping retailers in Minot and Grand Forks. Inventories are at acceptable levels, and no significant credit problems have been reported.

Motor vehicles continued to sell well throughout the district this spring. The car and truck sales of one domestic manufacturer were around 10 percent higher during the first three weeks in May than they were a year ago. Another domestic manufacturer reports that its truck sales were up by even more than 10 percent during May. Smaller dealers in outstate areas have done particularly well this year, but sales at larger dealers in metro areas also surged in May. The rapid sales growth has left inventories a bit tight.

While housing activity this spring fell from its record-setting pace of a year earlier, sales haven't been bad. In April, the total value of homes sold in the Minneapolis-St. Paul metro area was only 6 percent lower than in April 1987. A representative of Minnesota realtors proclaims the market to be "healthy across the board." Supporting this claim elsewhere, a reporter in Sioux Falls, South Dakota, observes that the city's housing market was "stable, but not booming."

Nonresidential Construction

Several significant construction projects have been announced recently. A large computer company released plans to add 76 stories of office space to downtown Minneapolis. A financial forms maker chose a St. Paul suburb (over five other sites outside the district) as the location for a large office and factory complex, which could employ another 1,500 workers. Contracts for the construction of public infrastructure in Minnesota were up substantially this March, while contracts awarded for other types of construction were down.

Resource-Related Industries

More favorable news was generated by the district's important forest products and mining sectors. A paper industry consultant notes that the paper

business has been booming, with all Minnesota mills running "flat out." Prices for printing paper are particularly firm. More paper machines may be installed later this year. Plants producing waferboard, a paper-based building material, are also running at full tilt, although prices are weak. After five years of hard times, the district's iron ore industry is recovering a bit. During April, iron ore shipments from Duluth and Superior to steel mills across the Great Lakes were 27 percent higher than a year earlier. An iron ore facility in northeastern Minnesota will recall around 80 laid-off workers to reopen a production line last used six years ago. Iron ore output is also up in Michigan's Upper Peninsula, where hiring has sometimes exceeded the number of workers laid off. And in Minnesota a plan has been spawned to convert abandoned iron mine pits into farms for salmon and trout production.

Agriculture

Excessive dryness has become a major concern for district farmers, although most other developments have been favorable. Topsoil moisture is short in Minnesota, northern South Dakota, and eastern North Dakota. But a Bank director from Montana reports that some rains in May helped a lot in that state. More favorably, prices of important district crops and livestock have risen. The Minnesota farm price index rose in April. The price received for wheat rose 10 cents over the previous month. A Bank director from North Dakota notes that soybean prices have been particularly strong, and another from Montana notes that cattle prices have reached record levels. Through mid-May, grain exports shipped from Duluth and Superior ran three times higher than last year. But a director from Wisconsin reports that dairy milk production has grown to levels that preceded the federal herd buy-out program--a program intended to curb excess production.

TENTH DISTRICT - KANSAS CITY

Summary. The economy of the Tenth District continues to make modest gains. Variation across the district and among industries is evident, however, in comments of directors and small business council members. Retail sales overall are generally weak, although new car sales are steady to slightly better. Prices of manufacturers' inputs continue to rise, and lead times have increased somewhat for some materials. Conditions are generally stable in the district energy sector. New home sales have slowed and housing starts are at or slightly below last month's levels. Total deposits at commercial banks are up from a month ago and loan demand is generally stronger. Dry weather is now the principal concern for district crop farmers.

Retail Sales. Tenth District retailers report that overall sales are generally weak. Competition and slow sales are tending to restrain price increases. Nearly all respondents report some trimming of inventories as well as continued tight inventory management. Most hope to reduce inventories further. Sales are expected to show little improvement in the months ahead.

Automobile Sales. Automobile dealers generally report that sales are holding steady to increasing slightly. Inventories are generally stable to expanding slightly. Adequate financing is available for both dealer inventories and customer purchases. Overall, dealers are fairly optimistic about sales for the rest of the year.

Manufacturing. Input prices have continued to rise over the past three months, and most respondents expect further increases in the period ahead. While materials are generally available, lead times have increased somewhat and some materials are becoming harder to get. Respondents are generally satisfied with inventory levels, with few plans to change them. Capacity utilization rates vary widely, ranging from 70 percent to nearly full utilization.

Energy. Conditions in the district's energy industry have been relatively stable, reflecting recent stability in crude oil prices. The average weekly number of operating drilling rigs in the Tenth District was 279 in April and March, but fell to 254 in May. Despite the recent decline in drilling activity, the rig count remains about 6 percent above the average recorded in May 1987.

Housing Activity and Finance. After strengthening the last few months, housing market activity has leveled off recently. New home sales are reported slow. Most homebuilders report housing starts at or slightly below last month's levels and down significantly from a year earlier. Although housing starts have leveled off, most respondents expect improvements in the near future. No problems are reported regarding prices, availability, or delivery times for construction materials.

Nearly all thrift institution respondents report that savings deposit inflows are near or above year ago levels. Most respondents expect flat or slightly increasing inflows in the near future. In general, recent mortgage activity has been weak. Mortgage rates are reported to be trending higher and are expected to stabilize or rise slightly further in the near term.

Banking. District commercial bankers report generally stronger loan demand over the past month. Demand for commercial and industrial loans, residential real estate loans, and commercial real estate loans have shown the most strength, while demand for consumer loans and agricultural loans have, on balance, shown little change. All but one of the respondents report they increased their prime rate one-half percentage point in the past month. Slightly more than half expect to increase their prime rate again in the near future. The rest expect to make no change in their prime rate. Most respondents report consumer lending rates have been stable. Expectations

about consumer lending rates are about evenly divided between no change and some increase. Total deposits are reported up over a month ago. MMDA's, passbook savings accounts, and small time deposits account for almost all of the growth. Demand deposits, conventional NOW accounts, Super-NOW accounts, IRA's/Keough's, and large CD's are, on balance, little changed.

Agriculture. Dry weather is the principal concern across the Tenth District as farmers prepare to harvest the winter wheat crop and finish planting spring crops. A lack of moisture early in the year and a virus-caused disease, wheat streak mosaic, are likely to cause wheat yields in parts of Kansas and Nebraska to range from average to well below average. Late spring rains, however, boosted prospective wheat yields in other areas of the district and will likely sustain the crop to harvest. Respondents in Oklahoma, Colorado, and central and western Kansas report that wheat yields in their areas could be average to just above average.

Spring planting is nearing completion across the district. Corn planting is virtually completed and planting of other crops is on schedule. Moisture conditions have improved and are now adequate, following a period of drought stress for the spring-planted crops.

Respondents report that 90 to 100 percent of district farmers are participating in government wheat and feedgrain programs this year. Despite a recent surge in soybean prices, very little land was switched from corn production to soybean production. Farmers are likely to be very cautious in switching land out of corn production because that would reduce the acreage eligible for participation in future farm programs. In addition, planting decisions had generally been made before the sharp rise in soybean prices occurred.

ELEVENTH DISTRICT--DALLAS

After a period of modest, but steady growth during the second half of 1987, the District economic expansion has begun to show signs of increased sluggishness. Growth in manufacturers' orders has ebbed. Drilling activity has entered a period of slow, although persistent increases, after declining during last year's fourth quarter. Retail sales are weak and previously strong auto sales growth has faltered somewhat. Construction activity is still falling. Prices of District farm and ranch products have been edging downward, but they remain above a year earlier. Although deposits at District financial institutions continue to slide, the rate of decrease has moderated.

District manufacturing activity remains strong relative to the rest of the economy, but respondents report slower growth in the first half of 1988 than in 1987. Although construction-related manufacturers generally note weak demand, orders in Houston are said to be up modestly. Nonelectrical machinery sales are increasing. Primary metals producers say that reduced competition from imports has resulted in rising sales and higher prices for their products. Orders to transportation equipment manufacturers, particularly aerospace and defense-related firms, are expanding. Electric and electronic equipment respondents report continued strong demand. In some segments of this industry, notably semiconductor manufacturing, supply constraints are placing significant upward pressures on selling prices. In contrast, weak-to-negative sales growth has resulted in declining employment in the apparel industry.

District drilling has recently expanded moderately. After declining from October 1987 through January of this year, the rig count rose from February through May. Although rig activity is above the depressed levels of a year ago, recent increases have been quite modest. Gains in District well permit applications, however, are said to suggest that drilling may grow somewhat more strongly over the next few months.

District retail sales have fallen below a year earlier, but some respondents say recent declines may reflect the effects of the early Easter. Sales strength varies significantly among areas in the District, with marked growth in the Houston area, and particular weakness in Dallas and Austin. Several retailers said price increases in women's apparel have reduced sales of that product line.

Although District automobile sales have generally shown year-over-year expansion in the first half of 1988, signs have recently been mixed. While sales growth continued in Dallas during April and May, some slippage has occurred in early June. In Houston, April and May sales were below a year earlier, following expansion during the first quarter. Dealers express optimism about auto sales for the balance of 1988 because they expect the Texas recovery to continue.

Declines in District construction activity have abated somewhat in recent months, but the industry shows little evidence of a rebound. The total value of construction contracts continues to fall. Nevertheless, nonresidential building contract values appear to have stabilized, though at very low levels. Residential contract values are still falling, however, and nonbuilding contracts have lately declined markedly. The weakness in residential construction is concentrated in single family

building. Multifamily activity is extremely low, but is said to have little room to fall further. Previous sharp declines in contracting activity continue to push construction employment lower; these declines may abate should construction activity continue to stabilize.

Weather conditions and reduced cattle supplies have led to moderate reductions in District farm revenue expectations for 1988. Nevertheless, agriculturalists anticipate higher income this year than what they received during most previous years of the present decade. Although recent rains have alleviated problems in some areas, dry conditions predominate in much of the District and have reduced corn yields. Conversely, the cotton crop has been battered by high winds and hail in isolated areas, but replanting is underway. Revenues from livestock marketing are expected to fall in 1988, as placements of cattle on feed decline and as the impact of falling demand continues to affect lamb prices. District agricultural product prices have slipped lately, but are still above the levels of a year earlier.

Although April deposits at District financial institutions remained below a year earlier, they were above March levels and recent rates of year-over-year decline have been markedly slower than those predominating in 1987. Deposits at thrifts continue to grow and year-over-year rates of change are accelerating. At the large banks, assets and liabilities continue to ebb, but the rates of decline are more moderate than those of the second half of last year. Loan volumes at the large banks are declining in most categories, including business, real estate, and other loans.

TWELFTH DISTRICT — SAN FRANCISCO

Summary

The Twelfth District economy continues to expand, although the pace of growth appears to be slowing. The business sentiment survey reveals that, on average, growth expectations were higher than in the last report, although an increasing number of respondents are concerned about the possibility of recession. Capacity constraints are noted in a number of industries, and investment plans to expand capacity are reported to be cautious. Agriculture and resource industries continue to strengthen, although the forest products industry is threatened by possible cutbacks in housing starts and the reduced availability of raw materials. Interest rate increases are causing concern in several sectors, but the expected decrease in loan demand has not yet materialized.

Business Sentiment

Respondents to the Twelfth District business sentiment survey expect real GNP growth to be about 3 percent over the next four quarters, although 8 percent now expect a recession during that period. Respondents have become slightly more optimistic about the trade deficit and more pessimistic about inflation, with 77 percent now expecting a slight worsening in inflation.

Capacity Constraints

Respondents noted capacity problems in a variety of industries. There is concern about shortages of farm equipment, with demand expected to rise 5 percent this year. Delays are noted in obtaining chemicals, and respondents report chemical production in excess of stated capacity in some areas. Additional delays in manufacturing are blamed on shortages of raw materials and heavy machinery (including printing machinery). Aerospace manufacturing in the Northwest also is reported to be at capacity, and back orders for computer parts have been increasing.

Respondents report a reluctance to expand capacity by those firms facing constraints, although our survey found that most respondents continued to expect an improvement in total business investment spending this year. Manufacturers are reported to be retooling some plants to increase capacity, but are reluctant to make large investments. Several respondents report that manufacturers are seeking additional capacity through mergers and acquisitions rather than through new investment. Vacant plants in Idaho and eastern Oregon are being converted to new uses, and two aluminum plants idled last year have returned to production. Agricultural producers are using their increased incomes to reduce debt, rather than to expand operations. Some investment is reported in western food processing plants.

Resource Industries

Agricultural conditions continue to improve in the District, led by a strong cattle market. Cattle producers report the best conditions in 15 years and expect continued strong growth in prices and demand this year. High prices also are reported for tree fruits, grapes, and grains. The lack of moisture is causing some cattle producers to reduce herd size and may reduce crop yields in the Northwest, but sufficient supplies of irrigation water are expected in California.

Respondents in the forest products industry are beginning to note a slowdown. Shortages of logs remain a problem for small mills, and recent environmental actions are further reducing available supplies of timber. Concern about future demand also is mounting because of a possible slowdown in housing starts and a decrease in Japanese demand for lumber.

Mining continues to perform well, with increased exploration and investment noted in Arizona and Nevada. Energy extraction remains stable and above year-earlier levels.

Construction

Construction appears to be slowing in the District. Weakness is reported in single-family and multifamily construction in Utah and Arizona, and construction

remains depressed in Alaska. Although construction activity remains strong, some slowing of residential construction is being reported in Oregon and Washington, and continued high levels of construction in California are attributed by some respondents to attempts to beat threatened growth moratoria.

Retail Sales

Retail sales have remained relatively sluggish, although recent trends suggest some improvement. Retailers report increased costs of foreign soft goods, but the major weaknesses are in women's apparel. Auto dealers report strong sales of used cars and a shortage of trucks. Dealers also report deteriorating competitiveness of foreign cars vis á vis domestic cars. Sales of new cars remain moderate, although some respondents report slow sales as consumers wait for new incentive programs.

Banking

Respondents in the banking sector report few effects of higher interest rates at this point. The number of loan applications has slowed in Utah and Arizona, and a slight decrease in loan originations is reported in Oregon and some parts of Southern California. Increased loan demand to lock in current rates is reported by some bankers. Overall, however, higher mortgage rates appear to have caused a shift from fixed-rate mortgages to ARMs, rather than a decline in total demand.