## TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>District</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>First District - Boston</td>
<td>I-1</td>
</tr>
<tr>
<td>Second District - New York</td>
<td>II-1</td>
</tr>
<tr>
<td>Third District - Philadelphia</td>
<td>III-1</td>
</tr>
<tr>
<td>Fourth District - Cleveland</td>
<td>IV-1</td>
</tr>
<tr>
<td>Fifth District - Richmond</td>
<td>V-1</td>
</tr>
<tr>
<td>Sixth District - Atlanta</td>
<td>VI-1</td>
</tr>
<tr>
<td>Seventh District - Chicago</td>
<td>VII-1</td>
</tr>
<tr>
<td>Eighth District - St. Louis</td>
<td>VIII-1</td>
</tr>
<tr>
<td>Ninth District - Minneapolis</td>
<td>IX-1</td>
</tr>
<tr>
<td>Tenth District - Kansas City</td>
<td>X-1</td>
</tr>
<tr>
<td>Eleventh District - Dallas</td>
<td>XI-1</td>
</tr>
<tr>
<td>Twelfth District - San Francisco</td>
<td>XII-1</td>
</tr>
</tbody>
</table>
SUMMARY*

The pace of business activity reflected in most District reports ranges from healthy expansion to stable or mixed, with weakening noted only by St. Louis. However, contacts in several Districts were less optimistic than earlier about the outlook. A number of manufacturing industries are operating near capacity, and further upward pressures on prices were noted. Retail spending is generally lackluster though some segments are doing better. Several Districts report weakness in residential construction, but home sales are strong on the West Coast and in the Richmond District. Nonresidential construction has slowed in various areas of the country, though industrial building has strengthened in the Midwest. Rainfall in the second half of the summer relieved drought stress to agriculture in several Districts, though parts of the St. Louis District suffered further crop damage from hot, dry weather.

Manufacturing

Activity is expanding in numerous manufacturing industries and in most Districts. Rising exports and transfer of production from overseas as

*Prepared at the Federal Reserve Bank of Chicago based on information gathered prior to August 30.
well as strength of domestic demand have contributed to manufacturing’s rise. Some industries are at or near capacity including paper, chemicals, steel, and aluminum. Other sectors doing well include electronics; nondefense aerospace; and electrical equipment and instruments, particularly for installation in new plants and factory expansion projects. Demand for various types of nonelectrical machinery has strengthened, in some cases from low levels. Motor vehicle output plans have been revised upward in line with better-than-expected sales. San Francisco says that output of forest products is strong, though industry sources are concerned about weakening in housing. In contrast, Dallas and Boston report sluggishness in construction supplies. Other manufacturing sectors showing softness include personal care products and government purchases, including defense. Atlanta, however, notes an increase in shipbuilding to fulfill new Navy contracts. Apparel is mixed, with foreign competition still strong. Several Districts indicate that the overall manufacturing expansion is expected to continue, though Richmond noted somewhat less optimism among its contacts than earlier.

Construction and Real Estate

Housing market conditions vary widely around the country, from healthy to weak. Recent interest rate increases are thought to have prompted some potential buyers to act before rates rose further (New York) but discouraged other would-be buyers (Richmond). San Francisco reports strength in West Coast housing markets and rapid increases in home prices. Richmond indicates that new home sales stayed strong in August. Dallas reports that residential construction contracts and permits are
rising but from low levels. Slowing in homebuilding is noted by New York, Atlanta, Chicago, St. Louis, Minneapolis, and Kansas City, though some parts of the New York District have shown recent improvement or less slowing than expected. Weak multifamily building was reported by Chicago and Atlanta, though the latter has seen an upturn in two District cities.

Construction of factories has strengthened in the Chicago District, and industrial park construction has increased in south Florida with the boom in exports. The pace of office building construction varies considerably among major cities. Hotel building is booming in Orlando. Chicago contacts expressed concern about overbuilding of retail stores in some areas. Boston described capital spending by profitable stores as cautious; weak retailers are selling stores. Strong or increased highway construction was noted by Chicago and San Francisco.

**Consumer Spending**

Consumer spending was reported sluggish in most Districts. Cleveland and Minneapolis, however, noted an upturn in apparel sales in recent weeks. Other Districts were hopeful that an end to hot, humid weather would bring stronger sales of fall apparel and back-to-school items. Lines described as selling well include conservative clothing (Boston) and accessories, handbags, and women's at-home clothing (New York). Cleveland sees some strength in home furnishings, appliances, and electronics, but sales of furniture were reported lagging by Boston, New York, and Richmond. Sales of home improvement items were reported strong by Kansas City, but Boston said hot weather deterred sales of building materials.
Retail sales have picked up in rural areas following recent rains, according to St. Louis. Motor vehicle sales have been mixed.

Ordering by retailers is described as conservative and cautious. Inventories were viewed as generally satisfactory in the New York, Minneapolis, and Kansas City Districts, but Dallas noted stocks above desired levels, and Boston District stores with weak profits are cutting inventories. Extensive markdowns were reported by New York and Chicago. Dallas noted reports of continued high square footage per customer, holding down profits.

Resource Industries

Crop conditions vary widely. Timely rains in August helped crop conditions according to Richmond, Atlanta, Kansas City, and Dallas. However, hot dry weather in mid-August caused further crop deterioration in the St. Louis District. Minneapolis reports conditions largely unchanged there over the past month. This summer’s drought caused a sharper loss of corn and soybean production in the Chicago District than for the nation as a whole. Higher feed costs have squeezed livestock producers’ margins, as have higher water costs in the San Francisco District, but Kansas City indicates that drought-induced cattle liquidation has been limited. Richmond notes that higher livestock prices are expected to help offset the adverse effects on margins of the rise in feed costs. The past year’s climb in agricultural land values in the Chicago District slowed in the second quarter.
This has been a "roller coaster" year for forestry, according to Atlanta. Increased timber supply due partly to the drought, and reduced demand reflecting concerns about lagging housing starts, have cut lumber prices.

Oil exploration and development is expected by Dallas contacts to remain sluggish. The number of active drilling rigs has fallen since May in the Dallas District but risen, contrary to expectations, in the Kansas City District. Atlanta reports new oil discoveries in Alabama and Mississippi, and moderately lower oil production in the District.

Other Drought Effects

Low Mississippi River levels this summer because of the drought caused diversion of freight from barges to higher-cost rail and Great Lakes shipping. However, recent rains in the upper Midwest have helped raise barge traffic above a year ago at Memphis, where delays had been lengthy. The drought cut into demand for farm equipment, which was recovering in the spring from low levels, but added to demand in some other industries including pump manufacturing and well drilling.

Inflation

Rising raw materials costs continue widespread, and higher prices for components are increasingly being noted. Further price increases are expected. Some firms, however, are experiencing little or no cost pressure, because of long-term contracts or because they have worked closely with suppliers on cost reduction, according to Boston. Richmond
reports that materials and finished goods price increases in August were less widespread than in July. Various materials and components are in short supply, and lead times have lengthened further, prompting producers to try to raise their inventories of these items. Cleveland comments that concerns about rising costs and capacity limits are allayed by sizable profit and productivity gains, but Chicago notes that margins at some firms are being squeezed by increasing materials costs.

Reports on wage gains are mixed. Cleveland sees signs of somewhat higher labor costs, partly reflecting increased overtime. Boston’s contacts are evenly divided between those who see accelerating labor costs, especially for fringe benefits, and those who do not. San Francisco reports shortages of entry and low-skill workers, partly tied to the immigration law. Shortages of qualified retail salespeople are exerting upward pressures on wages. In contrast, St. Louis sees no substantial upward wage pressures even in industries running at capacity.

Finance
Trends in lending have been mixed. Business lending has been strong except in the Dallas District where business and real estate loans are leading the decline in total loans. Consumer lending ranges from soft to strong, with increases generally led by financing of car purchases. Real estate lending is weak in some areas and showing moderate gains in others. Business and consumer loan rates have risen as have funding costs. Boston area bankers expect further interest rate increases over the rest of 1988.
Retail activity in the First District continued to be generally lackluster through the summer, with high-fashion/high-price apparel and housing-related goods especially weak. Manufacturing activity is mixed, with some firms reporting more than double-digit gains in sales and orders compared to a year earlier but others only holding steady. Price increases appear to be picking up for a range of manufacturing inputs, perhaps including labor. Cautious optimism characterizes the manufacturing outlook, but some retailers are now scaling back 1988 plans.

Retail

First District retailers report that recent sales activity is generally sluggish. Vendors of core consumer items appear to be doing best: unit sales of moderate and higher quality conservative clothing and of pharmacy prescriptions are holding to last year's robust levels; purchases of high-fashion/high-price clothing, health and beauty aids, furniture, and building supplies are reportedly lagging. The hot summer has spurred sales of seasonal items while dampening customer interest in materials for do-it-yourself home improvements.

Retail profitability is declining, as gross margins move in tandem with sales and the labor market remains tight. Firms with good sales results are increasing wages and improving working conditions; weaker firms are trying to reduce their expenses, and some are laying off costly employees. While earnings are flat among the healthiest firms, most respondents report profit declines, and some are operating at a loss.
Compared to earlier reports, capital spending plans of retailers have turned conservative. Most of the more profitable respondents are expanding their operations, but slowly and cautiously. The weak firms are disinvesting — selling stores and reducing inventories — and spending funds on only the most necessary and immediately rewarding projects. Some retailers are strapped for cash. One regional distributor, noting weakness in its customer base, is tightening credit.

Manufacturing

First District manufacturers give mixed reports on recent sales activity. While a majority indicate that sales are strong, with gains of 18 to 25 percent above year-ago levels, over one-third say that sales are flat or disappointing. Order rates vary too: some firms have backlogs 15 to 19 percent above 1987 levels but others sense some softening. Demand for electrical machinery and instruments, particularly by the auto and chemical industries, was especially strong. Half of the First District manufacturers contacted have benefitted from strong exports, and two firms mentioned transferring production to the United States from overseas. In contrast, demand for building products and personal care products was sluggish, in part because retailers are reportedly keeping inventories under tight control. Government purchases are also down.

Earnings are generally described as very good. For the most part, inventories are also said to be in good shape. A third of the firms contacted report that their capital spending is 10 to 20 percent above last year's level. For the majority, however, capital spending is below or even with 1987.
Many firms continue to face price increases for materials like paper, plastics and metals. Increasingly, however, they also mention rising prices for other inputs such as motors, electronic components and castings. By contrast, one-third of respondents have experienced little or no cost pressure, either because of long-term contracts, or because they have worked closely with suppliers to achieve cost reductions. Most First District manufacturers are raising their own prices whenever competitive conditions permit.

While a few manufacturers are hiring or recalling workers, most report that employment is flat or declining. Two major regional employers have announced lay-offs affecting their operations worldwide. Respondents discussing wage pressures are evenly divided between those who believe labor costs - particularly fringe benefits - are accelerating, and others who see no such development.

Most First District manufacturers foresee reasonably clear sailing through year end but express considerable caution as well. One spoke of "walking on eggs." Another firm wants to be able "to jump either way" but is "erring on the side of caution." While most respondents appear unconcerned about rising interest rates, two mentioned that continued dollar appreciation might weaken their exports.
In general, the Second District economy registered a modest uptrend since the last report. Business activity picked up somewhat and several areas reported either an improvement in residential construction or less softening than was anticipated. Office leasing continued at a moderate pace while the pattern of department store sales was mixed. Demand for commercial loans remained strong at small- and mid-sized banks in the District.

**Consumer Spending**

The pattern of District department store sales was mixed during July as respondents reported results ranging from somewhat below to well above plan. A prolonged period of hot and humid weather was cited by several retailers as a factor in slower-than-anticipated apparel sales since consumers were reluctant to try on new fall clothes. Furniture and housewares were also somewhat weak. Among items mentioned as selling well were accessories, handbags, and women's at-home clothing.

Over-the-year sales changes in July ranged from -1 percent to +10 percent with most stores registering a net gain. Inventories were generally reported in good shape, due in part to heavy markdowns of summer merchandise. However, one respondent noted that stocks are somewhat higher at his store than planned. After about a year of sluggish sales of women's apparel, all are hopeful that the new fall fashions will be able to turn things around.

**Business Activity**

Economic conditions in the Second District have picked up somewhat recently. The percentage of Buffalo purchasing managers reporting an improvement in general business activity increased in July while the percentage
with a worsening declined. A semiannual survey of manufacturers in the Syracuse area found that four-fifths of the responding firms were operating at a capacity of 80 percent or higher, up from only 50 percent at that operating level in January. Purchasing managers in the Rochester survey generally reported stable conditions and most anticipate little change over the next quarter.

Unemployment rates in the District remain lower than the national average with July readings of 4.1 percent in New York and 3.6 percent in New Jersey. A midyear review of labor market conditions in the New York-Northeastern New Jersey area noted that the first half of 1988 saw continued but slower job growth compared with the last half of 1987 and much lower unemployment than a year earlier. For the first five months of 1988 the area's unemployment rate averaged 3.8 percent, down from 4.7 percent a year earlier. Thus, despite cutbacks in New York City's finance and manufacturing sectors, the predicted large increase in regional unemployment has so far not materialized.

Residential Construction and Real Estate

While the overall pace of homebuilding activity remains somewhat slower than in the past few years, several areas reported either an improvement in recent weeks or less softening than had been anticipated. The moderate rise in mortgage interest rates reportedly has motivated some potential buyers to act now before rates move higher. In addition, some upstate New York communities continue to experience stronger homebuying and higher levels of residential construction than a year earlier. The outcome of several cases now under litigation will have a decided impact on future residential construction in the District. Hundreds of units of affordable housing have been mandated in a number of communities, but several plans for implementing the mandates are being challenged in the courts.

Office leasing activity has continued at a moderate pace since the last report. The expansion of foreign firms was a major factor in both midtown and
downtown Manhattan leasing, and negotiations with several other international companies are reportedly underway. In addition, some financial services firms which had earlier contemplated moving have decided to remain in lower Manhattan, where excess space has made rental rates and other terms more flexible. With little or no new office construction planned, vacancy rates in Westchester and Fairfield counties have either declined or stabilized in recent months, albeit at high levels. A modest slowing has also occurred in office construction in northern New Jersey where the overall vacancy rate remains about 20 percent.

Financial Developments

Officers of small- and mid-sized banks in the Second District report that demand for commercial loans continues to be strong. The majority of bankers said that demand is the same or greater than a year ago. The few who noted a decline in activity attributed the slowdown to a weak commercial real estate market, particularly in Stamford and northern New Jersey. Except for the real estate sector, nearly all respondents believed that their local economy is quite strong. Most officers expect that interest rates will continue to increase for the remainder of 1988, though some anticipate that rates will stabilize in early 1989. Higher interest rates have not as yet dampened commercial loan demand at the surveyed banks. Opinion was split as to whether further increases in rates would cause an appreciable reduction in loan activity in the next several months. Several bankers expect demand to continue brisk so long as the economy remains strong. Others noted that some clients have expressed apprehension concerning any further rise in rates. In terms of loan distribution, most of the officers said that the bulk of their loans go to established firms that are expanding or modernizing. However, some mentioned that they issue many small business loans and help finance new companies.
The Third District economy was still on an expansionary trend in late August although the retail sector remained slack. Manufacturing activity continues to increase moderately. Retail sales are flat compared to last year and merchants say the recent trend has been weak. Bank lending is moving up, particularly in business and construction loans. Bankers say personal installment and car loans are expanding but credit card lending is soft. Conditions in Third District recreation areas vary; business at seashore resorts is mostly off from last year while tourism at mountain resorts is up.

The outlook in the Third District business community is mostly positive, except in the retail sector. Manufacturers expect moderate growth to continue and they are planning increases in capital spending and hiring over the next six months. Bankers anticipate sustained loan demand, particularly from businesses, as economic growth continues. Retailers look for slow growth in the final quarter of the year but they do not expect real sales for the period to show any improvement over last year.

MANUFACTURING

Manufacturing activity in the region continues to expand, according to the latest Business Outlook Survey. Among firms polled in August, 32 percent reported increasing business while 16 percent indicated they were operating at a slower pace compared to July. Improvement is more widespread among producers of nondurable goods than in the durable goods sector.

Specific measures of industrial activity reflect modest gains. New orders were increasing in August, and a pickup in shipments is enabling area firms to reduce inventories marginally. However, order backlogs are unchanged and
payrolls at local plants are virtually steady, marking the first pause in employment growth—as measured by the survey—in 16 months.

Price pressures continue in the manufacturing sector. Nearly two-thirds of the companies contacted for the August survey reported increases in input costs from July, and almost one-third said they were raising the prices of the products they make. The outlook is for further price increases. Three-fourths of the survey respondents expect to pay more for the goods they purchase over the next six months and more than half plan to charge more for their own products.

Looking ahead, area manufacturers expect moderate growth to continue; 34 percent of the August survey participants predict improving business in the next six months while only 9 percent anticipate a slowdown. Overall, respondents expect increases in new orders and shipments and further reductions in inventories. Area firms intend to add workers in the next six months, on balance, and they plan to step up capital spending as well.

RETAIL

Third District retailers contacted in late August generally indicated that sales in late July and early August were about level with the same period last year, in real terms. Merchants say apparel sales remain weak, but there is some strength in home furnishings, appliances, and electronic goods. Unusually hot weather was aggravating the seasonal slowness, according to store officials, deterring customers from beginning back-to-school shopping.

Area merchants expect sales to improve only slowly through the fall, and they are anticipating a final quarter that will probably just match last year's when measured in constant dollars. In line with a flat projection for sales, retailers are cutting back plans for new store openings.
FINANCE

Loan volume at major Third District banks was growing at about a 13 percent annual rate in July and early August and bankers contacted late in the month said this pace appeared to be continuing. Several banks reported strong demand for commercial and industrial loans, prompted by increases in capital spending by local businesses as well as by inventory financing needs. Lending to contractors for office and flex-space construction has picked up although the growth of real estate lending overall continues to ease. Bankers say consumer lending has been strong recently, with car loans and installment loans moving up, although credit card lending is flat.

Several banks in the Third District have mounted promotional campaigns to raise deposits with 1-2 year maturities, and these banks generally have met their goals. While most bankers contacted in August said funding costs have remained under control, several expressed concern that they will not be able to maintain their current rate of asset growth unless they can boost deposit growth further, and that this will require paying higher rates of interest.

TOURISM

Tourism business is mixed in the Third District. New Jersey beach resorts have suffered from sporadic pollution incidents and a period of abnormally cold ocean water temperatures. Lodging and other tourist-related business at these resorts is off around 15 percent from last year, according to municipal officials and local merchants. Overall tourist business at Delaware beach resorts is up around 5 percent from last year, but local merchants say retail business has not matched the increase in visitors and rental activity. Pennsylvania mountain resorts in the Third District are experiencing better than expected business; tourist officials say gross revenue in vacation-related business is running about 9 percent above the year-ago level.
Summary

The Fourth District economy continues to enjoy a healthy expansion. Manufacturing production and new orders are at reportedly high levels with only moderate labor cost increases. Unemployment rates around the District have fallen to equal the national rate, but factory workers' average weekly earnings remain flat. Retail and auto sales are sluggish, and banks report strong business lending but slow consumer lending.

Retail Sales

Major retailers in the District report a noticeable upturn in sales in recent weeks compared with meager sales volumes during July. Sales of men's and boys' wear are brisk, and sales of women's fall fashions are picking up as the weather cools. Nonetheless, retailers have been conservative in placing fall orders. Firms report that they have encountered no capacity constraints when purchasing merchandise from domestic suppliers.

Local auto dealers report that sales in the last two or three weeks have been slow to moderate. One dealer attributed the slow sales to higher interest rates, and another noted that buyers don't want variable-interest-rate loans because they expect rates to rise further. Another dealer suggested that frequent changes in incentive programs over the last several months have confused potential buyers, making them more reluctant to make a purchase decision. However, dealers report that those who do buy show no sign
of becoming more cautious in their spending and continue to purchase many options for their cars. Dealers are generally satisfied with inventory levels, but are prepared to offer discounts or rebates if necessary to make room for the 1989 models.

Labor Markets

Unemployment rates in Ohio and Pennsylvania have converged to the national rate for the first time in a year. The current reduction in Ohio's unemployment rate marks the sixth straight month of steadily falling rates. The latest improvement results both from the addition of 62,000 workers to the ranks of the employed and from a reduction of 49,000 (or 15 percent) in the number of unemployed workers.

The new jobs appear to be slightly less concentrated in the services than they were earlier in the year. For instance, durable-goods employers added 5,200 jobs in Ohio. According to industry sources, most of these jobs are in the smaller companies that supply the major manufacturers, rather than in the large manufacturers themselves.

Ohio's lower unemployment rate has not yet affected factory workers' hourly earnings, which have remained flat over the last few months. However, the liberal use of worker overtime by District manufacturers to meet production schedules has increased the average workweek by 0.2 hours to 43.3 hours, pushing average weekly earnings up $4.47.
Manufacturing

The District's manufacturing sector continues to enjoy a healthy expansion. According to the Federal Reserve Bank of Cleveland's Ohio Manufacturing Index, production rose 5.8 percent during the last three months over the same period a year ago. Optimism about further expansion is buoyed by the high rate of incoming orders, as reported by purchasing managers. However, recent surveys indicate mounting concern about rising material costs, capacity constraints, and recent signs of somewhat higher labor costs. However, these concerns are tempered by reports of sizable profit and productivity gains.

A wide variety of commodities, particularly bearings, electric motors, and a number of chemical, steel, and aluminum products, remain in short supply, leading in some cases to price increases. Producers are coping by increasing their inventories of raw materials. The high volume of new orders and the steady backlogs of existing orders are expected to absorb this slight inventory buildup.

The metals sector continues to boom. Raw steel production in Youngstown, Pittsburgh, and Lake Erie regions rose 12.4 percent during the last three months over the same period a year ago. Although production has expanded significantly, upward price pressure is reported on many steel products.
Banking

District loan demand has been mixed, with strength in business lending, moderation in real estate lending, and softness in consumer installment lending. Total loans outstanding at large banks fell at an annual rate of 4 percent over the first half of the third quarter. After increasing at a rapid pace during the second quarter, consumer installment lending has subsided, which led to a slight overall contraction in loan volume. Also, real estate loans have been increasing at a slower rate than during the spring when mortgage rates were lower. In contrast, business lending has picked up considerably, with commercial and industrial loans outstanding growing at an annual clip of more than 20 percent.
Overview

Economic conditions in the District appear somewhat less robust in August than in July. Manufacturing activity increased at a slower pace, and manufacturers were somewhat less optimistic about the outlook. Department store sales were unchanged while furniture and car sales were down. The market for new homes remained strong. Exports rose and imports fell at District ports. Bankers reported moderate increases in consumer and real estate loans. Agricultural conditions improved somewhat with the recent rainfall.

Only one-fifth of manufacturers, but over half of our retail respondents, said they had raised wages during the month. Meanwhile, some slowing in producer price increases was evident.

Consumer Spending

District retailers responding to our regular mail survey reported decreased activity in the ten days ending August 17 compared with the previous ten days. Thirty-seven percent of the respondents reported declines in sales and 21 percent reported increases, as compared with 33 and 48 percent, respectively, who responded to our previous survey in mid-July. Sales of big ticket items were down according to about one-fourth of the respondents while 65 percent reported no change. Within the retail sector, department store respondents generally reported no change in sales while the majority of furniture store respondents and car dealers reported declines. Inventories were also down.

Employment in August was roughly even with that of July among our respondents. About half of the retail respondents said they had raised wages during the first half of August.
Manufacturing

Manufacturing activity apparently expanded only slightly in August, according to our regular mail survey. Thirty-two percent of the respondents reported increased shipments, down from 38 percent in the previous survey. Reports of unchanged shipments increased to 46 percent from 38 percent in the previous survey. New orders, backlogs of new orders, employment, and the length of the workweek also increased, but only marginally. Slightly over half of our respondents reported no change in inventories of finished goods and materials and about one-fourth reported increases.

Prices of manufacturers' materials and finished goods continued to rise, but at a slower pace than was reported in July. The prices of finished products increased according to 21 percent of our respondents, and 61 percent reported higher prices for raw materials. The corresponding percentages in July were 35 and 69.

One-fifth of our respondents said they raised wages in August or expect to raise them before month-end. Most of these manufacturers said the wage increases were previously scheduled.

In our latest survey, District manufacturers were somewhat less optimistic about the outlook for the economy. For the first time in several months, respondents expecting a decline in national business activity in the next six months about equaled those expecting an increase. With regard to the outlook for their own businesses, 36 percent of the respondents believe their shipments will rise in the next six months and 26 percent anticipate declines. Producers who expect declines in their unfilled orders and workweeks exceeded the number who expect increases.
Housing

The pace of new home sales remained strong in August according to our telephone survey of District realtors and builders. Most of them reported that both sales and new listings remained at healthy levels. Only a few noticed a slowdown in activity, which they attributed to the recent rise in interest rates.

Finance

Executives of District financial institutions reported continued growth in their sector. About half of the respondents said that deposit growth was more rapid than a year ago, while only one reported a decline in deposits. Growth in consumer loans, home equity lines, and home mortgages continued at the moderate levels reported a month ago. Most of our banking contacts have not observed any change in loan or deposit trends.

Agriculture

District agricultural conditions improved somewhat in August as timely rains helped reduce the heat stress on crops in many farm areas. According to our contacts, the condition of the peanut and soybean crops improved, and tobacco is in generally good shape.

Corn yields will vary widely in the District this year. On the coastal plains of North Carolina, where most of that state's corn crop is grown, yields are expected to be excellent. In many other parts of the District, however, the rains came too late to help most of the severely damaged crop. Two successive summers of drought have Maryland farmers talking about planting more winter wheat and barley and less corn in the future.

Rising poultry prices are expected to help District producers maintain profits in spite of increased feed costs due to the drought. Cattle and hog producers also look for increased prices for livestock in coming months.
The Sixth District economy continued its spotty expansion in mid-summer with key manufacturing industries very strong, but services moderating and construction weak. Strength elsewhere in the U.S. economy appears to be dampening migration, especially in Georgia and to some extent in Florida. Retail sales have shown renewed sluggishness, though recent dealer incentives have sustained auto sales. Homebuilding remains soft and nonresidential construction has been declining in major regional markets, where inventories of space are high. Recent rainfall has improved prospects for crops and livestock in many areas earlier affected by the drought. Selected industries are producing at capacity and raising prices but wage increases are modest.

**Employment and Industry** Industrial activity appears to be generally healthy, with several export-related industries operating at capacity levels. In textiles, demand for carpet is strong; demand for apparel fabric is down, but producers expect that dampened imports will lead to stronger demand for domestic products. The wood products industry continues to do well, with both domestic and foreign demand expected to continue growing into next year. Paper and packaging materials producers, operating essentially at full capacity, report that they can easily pass on price increases. Increased foreign demand is expected to offset slower domestic growth for commodity chemicals; producers have been expanding facilities, and a new chemical plant was recently announced for Louisiana. Producers of specialty chemicals used by the paper and electronic industries also are doing well and are raising prices. Manufacturers generally are not experiencing tight labor markets or significant upward wage pressure.

The electrical equipment industry continues to benefit from the manufacturing revival as firms add production lines and build new factories. The electronics industry is being boosted by demand for personal computers and defense-related electronics.

Ship building has benefited from major new U.S. Navy contracts, which have also boosted demand for regionally-produced steel plate and increased employment rolls in
Alabama and Mississippi. Steel mini-mills are prospering from new business stimulated by the weaker dollar, and increased demand for can sheet has led to the expansion of a Tennessee aluminum plant.

**Consumer Spending** Retail sales in the Southeast slowed in August following a mild rebound in July; revenue was off from last year for several retailers. Although back-to-school sales in the region have not met retailers' expectations, the hope persists that fall sales will accelerate when the weather cools. In fact, retailers are fairly optimistic about the fall season, especially compared to their poor experience last year. Few expect a big jump in sales and they continue to order conservatively.

Car sales were brisk in August, helped by moderate model clearance incentives. The August volume was lower than a year earlier, when bigger incentives strongly boosted sales. Truck sales continue to post healthy year-over-year gains. Though Georgia and Florida account for about half the region's volume gain, Louisiana and Mississippi are posting the largest percentage gains.

**Construction** Overall, nonresidential construction was declining in mid-summer and was at its lowest level since last winter. Even the Georgia market, which has been posting the highest year-over-year percentage increases, has softened. South Florida's office market is notably weak, but industrial park construction has picked up as export trade booms. Elsewhere, Tampa's huge wave of new construction and absorption has begun to subside. However, hotel construction in Orlando is booming and the office market has been a bright spot in Nashville.

Residential construction dropped one-fifth in July from June's level, mostly from a slowdown in single family construction. Reduced migration continues to exert a drag on housing demand. Multifamily housing remains overbuilt in several major cities, including Jacksonville, Miami, Nashville, and New Orleans. In Atlanta, multifamily building permits and construction are up sharply from last summer's low levels; there also is evidence of an apartment price war. Tampa's condo market is expanding.
Financial Services  Business loans continue to exhibit strength, while real estate lending is flat because of the slowdown in home sales and the end of the refinancing boom. Consumer lending in Louisiana and Mississippi is showing strong growth as a result of vigorous car sales. Beginning July 1, legislation permitted commercial banks in Mississippi to acquire or be acquired by banking companies in Alabama, Louisiana, or Tennessee; the first inter-state deal was a proposed acquisition of a Mississippi bank by a Memphis bank.

Tourism  Tourism has been one of the best industry performers this summer even though there has been little growth over last year. Despite reports that travelers are cutting back both on length of stay and discretionary spending, Florida anticipates record-breaking fall and winter seasons. In Central Florida, the Space Shuttle Discovery is providing a strong boost to attendance at the Kennedy Space Center. Traffic at Orlando International Airport continues to grow rapidly, but the Tampa and Miami airports have reported significant declines this summer, primarily the result of flight cutbacks by Eastern Airlines. Also, New Orleans expects a drop in visitors and reduced hotel occupancy this fall following the spurt accompanying the Republican National Convention.

Agriculture, Forestry, and Mining  Most of the Southeast received badly needed rains in recent weeks; the moisture came in time to help a majority of crops. The forestry industry continues to experience a roller coaster year as prices of many common lumber products have fallen about one-fifth in recent weeks after earlier advances. The summer drought improved logging conditions and allowed lumber supplies to outrace demand. Fewer home starts are limiting demand and enhanced competition from Canadian producers, caused by reduced rail rates on Canada's nationalized railroads, may also have contributed to price weakness.

Coal production remains stable while oil production is down moderately from last year's level. Oil exploration in the region has yielded new discoveries in Alabama and Mississippi.
Summary. Reports on business activity in the District generally indicate solid expansion into the second half of 1988, though the rate of rise in activity appears to be less rapid than in the first half. Upward pressures on prices continue. Manufacturers in this region have been helped greatly by the strengthening in demand for capital equipment. Better-than-expected consumer spending for motor vehicles continues to support upward-revised production plans at plants in the District. Sales of major appliances have stayed near last year's record pace. Construction activity, in the aggregate, appears to be slowing. The drought has adversely affected the farm sector and some nonagricultural industries but boosted activity in a few other industries.

Labor Markets. Employment growth in the District states through this year's first half was somewhat slower than the nation in part reflecting first quarter layoffs at auto assembly and parts plants. Unemployment has been below 5 percent of the labor force in Indiana and near 4 percent in Iowa and Wisconsin. Illinois and Michigan rates have been above other District states and the nation. Labor markets have tightened in parts of the District but wage gains generally remain restrained, with some firms seeking concessions.

Motor Vehicles. Sales of domestic cars have remained strong, and domestic truck sales have set a record pace. The industry has been boosting production schedules to meet demand, following cuts earlier this year. Car assemblies in calendar year 1988 are projected about even with 1987, and truck production is expected to be highest ever. A large domestic producer assembling trucks on overtime is reported to be looking into expanding capacity, possibly using recently shuttered plants of another producer.

Steel. Production of steel slowed seasonally during the summer but is expected to come back strong. Some scheduled maintenance has been deferred in
order to keep output at a high level. Mill shipments for the year are projected highest since 1981. Among steel's major markets, domestic motor vehicle production has been revised upward this year; demand for steel from machinery makers has increased considerably; plant investment is rising in chemical process industries--paper, chemicals, petrochemicals, and refineries; and construction steel has stayed strong. Steel mill inventories are thought to have risen in July but are not excessive. Steelmakers in the District are investing in projects to boost quality and productivity.

Other Manufacturing Industries. Demand for a wide range of machinery types continues to rise, in many cases from low levels. Increased costs for materials are squeezing profit margins, however. Machine tool orders are double the year-ago pace. Railcar orders have doubled and backlogs have tripled. Demand for truck trailers is expected to stay strong, about at last year's pace. Construction machinery sales have improved sharply, encouraging investments in upgrading manufacturing plants. Major home appliance shipments are expected to be second-highest ever this year, 4 percent below 1987. Recreational vehicle sales are projected 8 percent above last year.

Construction. Construction activity is at a fairly high level in the District, but segments of the industry are slowing and further slowing appears in prospect. Contracts for construction of nonresidential buildings, in square feet of floor space, were 5 percent lower in the first half than a year earlier in District states. Residential construction contracts were 11 percent lower. In contrast, first half shipments of gypsum board in District states were 1 percent higher than a year earlier, reflecting finishing work on projects begun earlier. Apartment construction is weak, and home building has also started to slip. Further slowing is expected in response to higher mortgage interest rates. Industrial building is strong in the District. Office construction remains strong in downtown Chicago, though below the record pace of recent
years, and also has been strong in other District cities including Des Moines, Indianapolis, and Milwaukee. Office construction is slowing in suburban Chicago, and is expected to slow in downtown Indianapolis. Total Detroit area nonresidential construction probably peaked last year. Some types of public works construction are very active including streets and highways.

Consumer Spending. Apparel sales, particularly fall merchandise, were hurt by hot weather in July after a stronger performance in June. Markdowns were described as widespread, depressing dollar volumes. Contacts expressed concerns about overbuilding of retail space in some areas.

Drought Effects. The drought, relieved somewhat by increased rainfall and cooler weather in recent weeks, has cut crop yields sharply and pared farm equipment sales. Barge traffic was cut by low water levels, helping rail and Great Lakes transport alternatives to barges. Other industries which gained as a result of the drought include pump manufacturers and well drilling. The absence of rain earlier in the summer allowed construction projects to proceed ahead of schedule. Demand for farm equipment, grain storage facilities, and landscaping supplies and services may come back strong next year.

Agriculture. Crop losses due to the drought were sharper in the District than in the nation. The USDA estimates year-to-year declines of 42 percent in District states' corn production and 27 percent in soybeans. Higher feed costs have squeezed livestock producers' margins. However, recent disaster assistance legislation will cushion adverse drought effects on crop and livestock farmers. District farmland values rose during the second quarter but more slowly than in the previous four quarters. Although the District as a whole was up 1 percent from three months earlier, gains were not reported in all five states. Contacts were less optimistic than earlier about the near-term trend in farmland values.
EIGHTH DISTRICT - ST. LOUIS

Summary
The District economy continues to weaken. Employment and construction activity have declined recently. Real consumer spending has exhibited little growth with car sales weakening. Manufacturers in several industries, however, are running at maximum capacity. In banking, weakness in consumer and real estate lending continues, however, commercial loan growth remains strong. Dry weather in mid-August has harmed crops further. River transportation has improved.

Employment
Following a strong first quarter, District nonagricultural employment declined at a 1.1 percent annual rate in the second quarter. While all nongovernment sectors reported job losses, declines were particularly severe in the mining and construction sectors. District manufacturing employment fell at a 2.7 percent rate last quarter with sharp drops in the food processing and textile and apparel industries. Many chemicals producers, saw mills and paper manufacturers, on the other hand, are running at maximum capacity due to a rapid increase in exports and strong domestic sales. Some paper mills have imported pulp to maintain their supply. Nevertheless, no substantial wage hikes have been reported in these industries. A St. Louis auto assembly plant plans to call 2,500 auto assembly workers back to work in September.
Outlook

A July survey of District small businesses revealed a more pessimistic outlook than a survey conducted one year earlier showed. A substantially larger proportion of respondents in the recent survey anticipate a decline in real sales volume and a weakening in business conditions in the following six months. There was no change in the proportion of the total sample that planned to raise prices in the near future, though a considerably larger share of respondents from the manufacturing sector planned price increases. The survey also revealed a shortage of skilled construction and transportation workers.

Consumer Spending

District consumer spending in recent months has been only slightly higher than a year earlier, after adjusting for inflation. Car sales leveled off in August but spending for services was moderately strong. Grocery stores sales in St. Louis are picking up slightly, despite higher prices. Sales are increasing in some agricultural areas of Arkansas, reflecting farmers' improved outlook following recent rains.

Construction

Construction continues to weaken. In both the District and the nation, the value of total building contracts awarded in the three months through July was down approximately 4 percent from the previous three months. The May–July value of District contracts was down 8.7 percent from a year earlier as both residential and nonresidential building sectors weakened. In St. Louis, however, nonresidential building remains strong. In the second quarter, both office and industrial vacancy rates
in St. Louis were lower than they were a year earlier and were also below the national average.

Banking

For the three months ending July, total loans at weekly reporting District banks grew at an 8.5 percent annual rate, somewhat slower than the 10.7 percent rate reported for the same period last year. Real estate loans grew at a 12.9 percent rate, less than half the pace of the May-July period in 1987. Consumer loans declined during the three months, falling at a 1.2 percent rate. Commercial loans, on other hand, grew at an 11.9 percent rate, more than double the rate of the same period last year.

Agriculture

Extremely hot and dry weather caused District crop conditions to deteriorate in mid-August. An August 1 survey estimated corn yield losses in District states at 23 to 42 percent. Recent hot weather will further reduce these already weak yields. The northern half of Missouri is the area most affected by the drought with corn yields more than 50 percent below last year. In Arkansas, Kentucky and Tennessee, soybean yields were estimated at 4 to 8 percent higher than last year because of timely rains. The recent heat wave, however, will reduce yields. The District's cotton and rice crops, however, remain in very good condition. In addition, river transportation has improved because of above-average rains in the upper Midwest. Barge traffic at Memphis, a site of major delays earlier this summer, has been higher than a year earlier.
NINTH DISTRICT--MINNEAPOLIS

Ninth District economic conditions have remained stable. Employment prospects have stayed good. Consumer spending appears to have held up. Merchants contacted have not observed sharp price increases. Resource-related and agricultural industry conditions have remained largely unchanged.

**Labor Markets**

Recent tightness in the labor market has eased. Still, employment prospects remain good. Minnesota's unemployment rate increased more than seasonally in July, to 3.5 percent. This was primarily due to stronger-than-expected labor force growth, though, as employment remained higher than seasonally expected. In addition, initial unemployment claims in Minnesota fell in July, to a level 5.6 percent below that of a year earlier. The most recent data indicate that the unemployment rate in Montana has leveled off at 6.4 percent. And despite strong employment growth, North Dakota's unemployment rate rose a bit in June, but was still 0.8 percentage point below its level in June 1987. Seasonal construction and tourism-related employment in Michigan's Upper Peninsula brought that area's unemployment down to around 7 percent, well below that of a year ago.

**Consumer Spending**

Consumer spending on general merchandise may have picked up a bit in August. One retailer notes an increase during August, following a lackluster July. Another district retailer experienced good sales growth recently, led by strong sales of fall apparel. Inventories are at acceptable levels. Retailers' outlooks vary, with some predicting continuing strength while others (in the Fargo, North Dakota, area) worry that recent strength may be coming at the expense of lower activity later this year.
Motor vehicles have continued to sell well. One domestic line reports that its newer compact cars are selling particularly quickly. A domestic manufacturer notes that compact trucks are also a hot item, racking up double-digit sales increases for the month of July. With production going full bore, consumers will wait longer to take delivery on special orders this fall. Analysts contacted report good sales in such diverse locations as Billings, Montana, and Escanaba, Michigan.

The most recent statistics indicate that housing activity may be slowing a bit. Housing permits issued in the Minneapolis-St. Paul metropolitan area fell in June, dropping 14 percent below the number issued in June 1987. But 1987 was a banner year for Twin Cities homebuilding, with permit issuance comparable to Phoenix, Arizona. And Twin Cities sales of existing homes still rose above year-earlier levels during both June and July.

Tourist spending has continued to increase. Hot weather has helped attract tourists to cooler lakeshore areas. A tourism industry association reports a 30 percent increase in revenue for its members located on Lake Superior's North Shore, in Minnesota. According to local observers, tourist spending has been very good in the area around Pierre, South Dakota, and in the central part of the Upper Peninsula of Michigan. Forest fires are hurting visits to parts of Montana, though. Still, total tourist activity for the year in Montana has been high, and a newspaper editor comments that firefighting has brought employment to some unemployed workers and strikers.

**Consumer Prices**

Retailers of general merchandise report some wholesale price increases. One chain says prices rose at most 5 percent this year, with some goods actually declining in price. Food manufacturers have increased prices for products made from grains. But two supermarket chains believe retail competition will moderate the increase passed on to consumers.
Resource-Related Industries

The wood products sector has continued to perform well, although strikes have occurred at some Montana facilities. A furniture manufacturer will start up an operation in northern Minnesota this winter. Recently, ground was broken for a new paper machine in Michigan's Upper Peninsula, where the operator of large iron mines is expecting to report increased revenues following a small loss in 1987.

Agriculture

The condition of district agriculture has remained largely unchanged from our last report. Only two Minnesota counties weren't declared eligible for low-interest disaster relief loans to farmers and small businesses. One estimate indicates that Minnesota farmers will receive an average of at least $6,400 per farm from recent federal legislation to help relieve drought-induced financial problems. Low water levels have created difficulties for joint sharing of some Montana water resources by agricultural and tourist users.
Overview. Economic activity in the Tenth District is mixed, with sluggishness in housing and retail sales and strength in manufacturing. New car sales are steady to slightly higher, but other retailers report steady to slightly lower sales. In the manufacturing sector, many firms are operating near capacity and lead times and input prices continue to increase. Housing starts are below last month's levels and mortgage rates are rising. Both loan demand and deposits have increased slightly at district commercial banks. Effects of the drought on row crops and livestock operations remain a major concern.

Retail Sales. Retailers generally report sales steady to slightly lower compared with a year earlier, as well as with a few months ago. Some retailers report strong sales in home improvement and entertainment products, while sales of certain lines of apparel have been weak. Most respondents are satisfied with current inventory levels, and are buying cautiously. Retailers generally expect only slow sales growth in the near term.

Automobile Sales. Automobile dealers report that sales are steady to slightly higher over the past month. Dealer inventories are down slightly due to the ending of the model year. Most dealers express optimism for future car sales.

Manufacturing. Many respondents report that plants are operating near full capacity. While materials are generally available, lead times have lengthened. In general, input prices continue to increase and most respondents expect further increases in the next quarter. Respondents consider inventory levels satisfactory or slightly high, and most plan to trim inventories in the near future.
Energy. The Tenth District's energy industry has been more resilient than expected in the face of weaker oil prices due to surging production by most OPEC members. Exploration and development activity in the district improved in July, despite domestic oil prices that averaged more than a dollar below June prices. The average number of active drilling rigs in the district rose from 258 in June to 268 in July. During the first three weeks of August the rig count increased to 274.

Housing Activity and Finance. Area homebuilders report that housing starts are below last month’s levels and at or below last year’s levels. New home sales and prices are generally steady and housing market performance is expected to remain steady. Inventories of unsold homes vary across the district depending on local conditions. A few respondents report some construction material shortages and higher material prices.

Nearly all savings and loan respondents report that savings deposit inflows are near or above year ago and month ago levels. Most respondents expect flat or slightly increasing inflows in the near future. In general, mortgage activity has been weak and this weakness is expected to continue through the end of 1988. Mortgage rates have been increasing, and most respondents expect them to rise slightly during the remainder of 1988.

Banking. District commercial banks report a slight increase in loan demand over the past month, with the greatest strength in commercial and industrial loans. All respondents increased their prime rates by 50 basis points in the past month. For some, this increase followed a similar increase in July and about half the respondents expect a further increase in the prime rate in the near term. Consumer loan rates also increased by 50 basis points at most of the banks surveyed. On average, deposits increased slightly at district banks, although a number of respondents report no change in deposits.
Agriculture. Crop and range conditions vary widely across the Tenth District. The effects of the drought on corn, soybeans, and other row crops remain of major concern. Timely rains in many parts of the district have improved crop growing conditions and limited crop deterioration since the USDA's August 11 crop report. Irrigated crops are generally in very good condition throughout the district, but the shortage of rainfall has boosted irrigation requirements and driven irrigation costs much higher. Planting of the winter wheat crop begins during the next few weeks, and timely rainfall will be critical to the crop's early development.

The drought has also had a significant effect on district cattle feeders and ranchers, but drought-induced liquidation of district cattle herds has been limited. Cattle feeding costs have risen, and scorched pastures and reduced forage production have forced the movement of cattle from drier areas to areas with better grazing conditions. Development of winter wheat pastures this fall will depend on rainfall received during the next month. If wheat pastures prove to be inadequate, further liquidation of district cattle herds may occur.

Despite the drought, most agricultural bankers in the district anticipate little change in the rate of loan repayments from last year. Most borrowers were able to rebuild financial reserves in recent years, and this year higher crop prices will help offset smaller crop yields. Most district farm lenders and borrowers will be able to withstand the effects of the drought.
The District economy continues to grow slowly. Orders to manufacturers are rising modestly. Oil and gas drilling activity has been weakening. Retail sales are edging upward. Overall, auto sales are climbing, but they are greatly varied across the District. The protracted decline in construction activity appears to be over, but a major rebound shows little evidence of materializing. Rising prices for agricultural products have largely offset the financial impact of drought-related declines in District crop yields. Assets of financial institutions are still slipping, but the rate of decline has flattened. Although optimism about prospects for the District economy remains fairly widespread, an increasing minority of respondents are expressing concern over a possible U.S. economic downturn in 1989, and an allied decline in the District.

District manufacturers generally report rising orders, but they say that recent sales growth has been slower than the expansions of the second half of 1987. Orders are rising fastest at firms producing electronics, primary metals, and chemicals. For chemical producers, capacity constraints continue to hold down production below desired levels and low product inventories are said to have become a problem at some plants. Reports of sales growth by apparel manufacturers are mixed. Competition from foreign sellers in this industry is said to remain strong. Manufacturers that supply the construction industry - including producers of lumber and wood products and stone, clay, and glass - continue to note that their sales are weak. District aircraft production, much of which is defense-related, is little changed. Among food processors, demand growth
is consistent with what they characterize as the overall slow growth of the southwestern economy.

District retailers say sales have been growing recently but that increases have been slight overall. As a result of unexpectedly sluggish sales, inventories are higher than desired. Some retailers note continued high ratios of store square footage per customer in the District's larger cities and they say that this phenomenon has held profits down. Respondents express guarded optimism about future sales, but they expect the District economy to continue its recovery through the end of 1988 and they believe their sales will go up accordingly.

District auto sales are generally up, but there is wide variation across areas. While sales in Houston are showing strong expansion, the auto market has been very soft in Dallas/Ft. Worth. Dallas dealers say they are having difficulty getting as many cars as they think they can sell because of their weak sales in the past.

District construction activity has recently increased, but it remains at low levels. Due to gains in Louisiana and New Mexico, the value of construction contracts in the District rose moderately in the second quarter. These recent expansions have been fairly evenly distributed between nonresidential and residential building. Rising residential permit issuance is said to suggest some further strengthening in residential activity for the near future. Despite these increases, District construction employment continues to decline. Respondents say that employment reductions are likely to abate this year in a lagged response to the end of declines in contract values.
District drilling is weakening. After four months of moderate gains, the District rig count fell in June, July, and the first half of August. The rig count has declined 14.4 percent since May and has reached its lowest level since June 1987. Although well permits were up slightly in June, respondents do not expect any significant rebound in oil prices and they accordingly anticipate ongoing sluggishness in drilling activity.

Drought is not expected to reduce District farm cash income significantly in 1988. Unlike most drought-stricken areas of the United States, the District's moisture conditions have lately improved. Furthermore, grain prices have risen as much as 50 percent from a year earlier, while drought-caused reductions in production have been small. Strong demand has also pushed up cattle prices. The Texas All Farm Products Price Index was 12 percent higher in July 1988 than in July 1987. Among reported crops, only upland cotton has experienced declining prices. Cotton yields are about the same as a year ago.

Total deposits at District financial institutions continue to show year-over-year declines, but rates of reduction have lately diminished. In July, total deposits were only 0.1 percent below a year earlier. The weakest categories remain large time deposits and MMDAs. Loans at large District banks have continued to fall, led by declines in business and real estate loans. Holdings of securities are also declining.
TWELFTH DISTRICT — SAN FRANCISCO

Summary

The economy of the Twelfth District continues to grow, although there are concerns about some segments of the economy. The Business Sentiment survey reveals that respondents are generally less optimistic about conditions than they were in the previous survey. Respondents, particularly those in the Northwest, expressed concern about the effects of a slowdown in housing threatened by recent increases in mortgage rates. Manufacturers of export-related products, commercial aircraft, and electronics report strong sales, although capacity constraints are becoming more binding. Agriculture is performing relatively well in the District, with expectations of continued strong export markets and strong prices.

Business Sentiment

Since the last report, respondents to the Twelfth District Sentiment survey have become slightly more pessimistic about economic growth. Expectations about housing starts are now at the most pessimistic level of the year, with 86 percent now expecting significant worsening. Respondents are still optimistic about further progress in reducing the trade deficit, although they are less optimistic now than at any point since April. Concern is growing about both inflation and unemployment.

Retail Sales

Retail sales remain sluggish — particularly sales of women's apparel — but the outlook for the Holiday season is healthy. Upward price pressure is cited as a result of higher import prices, but retailers are having difficulty passing those costs along. Retailers report some shortages of qualified sales persons and some upward pressure on wages. Automobile dealers expect prices of domestic cars to rise with this model year, although the mechanism will be through the inclusion of more options as standard
equipment, rather than through direct price increases. One dealer also cites increasing restrictions being placed on orders of domestic 1989 cars.

**Manufacturing**

Manufacturing activity is uneven across the District. Non-defense aerospace and electronics firms are doing well in Washington, Idaho, California, and Arizona, although cutbacks by IBM and a decision to not relocate by Hughes has hurt manufacturing in Arizona. California and Washington are being buoyed by the strength in Boeing's sales, although the defense-related aircraft industry is facing cutbacks. Forest products remain strong, but concern is mounting about a possible collapse of demand triggered by declining numbers of housing starts. One respondent reports that some softening of demand has resulted in mills operating 7 to 8 percent below capacity, and prices are lower for plywood and lumber. Heavy equipment manufacturers report gains in farm equipment sales and in sales to chemical and pulp and paper producers, although overall activity remains relatively weak. Aluminum and paper production is at capacity. Defense-related and durable manufacturing is picking up in Utah.

Industries in the Pacific Northwest report shortages of some raw materials and rising costs of those materials, although the cost has not been fully passed along to wholesale prices. Shortages of entry level workers are reported in a number of areas in Washington and Oregon. Moreover, shortages of low-skill workers are a concern to apparel and agriculture producers in California because of the immigration bill. Respondents also report a 15 percent increase in newsprint prices in Los Angeles, and a sharp increase in the cost of imported electronic equipment.

**Construction**

Construction has been slowing in the District and industry observers are concerned about further reductions in housing starts. Housing starts are very weak in Utah, Alaska, and Arizona. Residential construction remains healthy in California, Oregon,
and Washington, where prices continue to escalate at an extremely rapid rate. Weakness in energy and housing has slowed construction in the Intermountain region, although construction on mining facilities and on highways has increased.

Resource Industries

Agriculture is performing relatively well in the District. Production is off, but prices are up sufficiently to compensate. Most respondents expect prices to steady or decline. Premium grape prices are up sharply, although retail wine prices have not yet risen. Cattle prices are rebounding and inventories are diminishing, but feed and water costs remain high. Seafood products have heavy inventories, and prices may decline. Mining activity is up sharply in the District, with continued expansion of gold mining facilities in Nevada. Energy activity remains sluggish.

Exports

Exports remain strong throughout the District. Manufactured products, agricultural products, and forest products are all facing expanding markets. No sign of weakening because of the rising dollar are noted yet. Wine exports have doubled in the last two years. Activity at Pacific ports is reported to be at very high levels.

Financial Sector

Respondents reported an increase in costs of funds and in loan rates following the discount rate hike, but conditions appear to be improving in the financial sector. Costs of funds and loan rates have increased by 25 to 50 basis points. Competition for quality loans remains strong in the faster growing portions of the District, reducing margins for many banks. Conditions in the Intermountain area and in agricultural areas are improving with the improvement of the region's economy. Nonperforming loans have fallen 10 percent in Idaho since the beginning of the year.