

SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICTS

NOVEMBER 1988

TABLE OF CONTENTS

SUMMARY.....	i
First District - Boston.....	I-1
Second District - New York.....	II-1
Third District - Philadelphia.....	III-1
Fourth District - Cleveland.....	IV-1
Fifth District - Richmond.....	V-1
Sixth District - Atlanta.....	VI-1
Seventh District - Chicago.....	VII-1
Eighth District - St. Louis.....	VIII-1
Ninth District - Minneapolis.....	IX-1
Tenth District - Kansas City.....	X-1
Eleventh District- Dallas.....	XI-1
Twelfth District - San Francisco.....	XII-1

SUMMARY*

Most Districts report continued economic growth, but at an apparently slower pace than in previous months. Only Dallas, St. Louis, and Kansas City report generally sluggish business conditions and cite persistent weakness in many sectors. Much of the activity in the faster-growing Districts appears to be generated from strong exports and a steady demand for capital goods. The brisk production pace continues to be supported by growing new orders. Wage increases are moderate, although labor markets continue to be tight. Capacity pressures, and consequently price pressures, have reportedly eased slightly in several industries, including paper, chemical, steel, and textiles.

Improvement is noted in the drought-stricken Districts, except Dallas, as damage estimates are revised downward and more favorable weather improves soil conditions. Residential construction is sluggish throughout most of the Districts, but nonresidential construction remains brisk in several Districts. Retail sales are slow, but some optimism is expressed about prospects for the holiday shopping season. The moderate increase in loan demand has been driven primarily by strong commercial loans.

RETAIL TRADE

Retailers report flat to moderate sales as they enter the holiday shopping season. Several Districts in the eastern half of the nation, including Boston, New York, Philadelphia and Cleveland, express optimism about the apparent turnaround in women's apparel, which has been particularly weak for

* Prepared at the Federal Reserve Bank of Cleveland using information gathered prior to November 18, 1988.

several months. However, department store managers in Cleveland and Philadelphia expect price increases to dampen to some extent the recent rebound in apparel sales.

Inventories generally remain light, as retailers anticipated the recent sluggishness in sales and continue to be cautious in stocking shelves for the winter months. Merchants in Kansas City, Minneapolis, and Philadelphia report that inventories are at acceptable levels. Only Richmond reports that inventories, especially in large departments, were higher than desired.

Despite the slim inventories, many retailers are pursuing widespread discounting. However, Philadelphia managers report that the price discounting is in line with their planned pricing strategies. Several Districts, including Kansas City and Cleveland, report some pressure on wholesale prices, which may squeeze even further the profit margins of these businesses.

Retailers express guarded optimism about sales prospects for the holiday season. New York, Minneapolis, and Kansas City merchants anticipate good holiday sales, especially compared with the post-October consumer sentiment of last year. St. Louis and Philadelphia managers were less optimistic and expect only slight increases from a year ago.

Automobile sales are sluggish in most Districts, except for reports of strong sales in Chicago and Minneapolis. Philadelphia, Richmond, and Kansas City report expanding inventories, which could prompt more dealer incentive and rebate programs.

MANUFACTURING

All Districts report expanding production, but many report a slower rate of growth than in previous months. Traditional durable-goods industries show

considerable strength, even more so than many "high-technology" industries. Cleveland reports that strong capital-goods demand and rising exports have fueled rapid advances in nonelectrical machinery and primary metals. Chicago and Atlanta also note strength in durables and steel production. Boston, Dallas, and San Francisco, on the other hand, report sluggishness in defense and computer-related industries, especially electronic equipment manufacturing and semiconductors.

The expansion in manufacturing continues to be supported in most Districts by rising new orders. However, some of the pressure on capacity has been eased, as evidenced by a reduction in the backlog of orders and shorter delivery times.

Many industries, including paper, chemical, and aerospace, are still operating at or near capacity. San Francisco reports that capacity constraints are clearly evident in the commercial aircraft industry. Atlanta reports that the chemical industry is running close to capacity, bidding up wages for skilled labor and creating tight supplies of ethylene and propylene. However, these same Districts also report some retreat from the high levels of capacity seen earlier in the paper, textile, and apparel industries.

Despite general tightness in many District labor markets and reports of shortages of skilled workers, only moderate wage increases have been observed. Cleveland reports that area compensation managers are budgeting about the same level of wage and salary hikes for the coming year (4.6 percent) as granted in 1988.

Prices continue to increase in many sectors, but do not appear to be as large or as widespread as recorded in previous months. Chicago reports that

upward pressures on steel prices have eased after sharp increases earlier. For the first time in several months, less than half the purchasing managers surveyed in Cleveland report general commodity price increases. Manufacturers in the Atlanta District say they have not increased their prices because domestic competition is strong.

Only a few Districts mention plans to increase capital spending. Boston mentions plans for several new plants in their District, but notes that overall capital spending plans are mixed. Chemical, textile, and nonelectrical machinery manufacturers in the Philadelphia District have announced planned increases for both modernization and capacity expansion.

AGRICULTURE AND FORESTRY

Drought-ridden areas generally report improving conditions as fall rains begin to replenish soil moisture. Some Districts are revising downward earlier estimates of crop damage. Chicago reports that crop yields are slightly higher than earlier estimates. More current estimates show corn production to be 41 percent lower and soybeans 29 percent lower than last year in the District. St. Louis reports that conditions continue to improve as recent rains have benefited the winter wheat crop and have improved pastures. Kansas City also reports that the severity of the drought has been revised downward. Lenders in that District expect strong farm incomes from higher prices and anticipate little change in loan repayment rates.

Dallas is the only District reporting worsening drought conditions. Many pastures and ranges are bare, and without significant rainfall this winter, the cost of supplemental feeding may threaten the profitability of cattle operations in some parts of the District.

San Francisco reports that the demand for lumber and plywood has fallen in recent weeks, causing prices to erode slowly. However, log and timber prices remain firm due to continued exports. Atlanta notes that foreign demand for hardwoods by Japan and the United Kingdom has helped support prices of hardwood logs.

CONSTRUCTION AND REAL ESTATE

Housing construction remains slow in most Districts, except for a few isolated pockets of strength. Richmond reports fairly strong demand for single-family homes, and San Francisco notes relatively brisk activity in California, Oregon, and Washington. New York attributes the weak demand for new homes and a slow resale market in much of their District to persistently high prices.

Several Districts find relatively brisk activity in nonresidential construction. St. Louis notes that the expansion of nonresidential construction exceeds the national rate. Atlanta attributes the increase in warehouse and industrial construction in their District to strong exports. Chicago reports vigorous commercial building activity in downtown Chicago.

FINANCIAL

Loan activity among Districts ranges from flat to moderate. Philadelphia reports good loan growth, particularly for commercial lending, but notes some easing in recent months. St. Louis and Kansas City record weak loan demand, on the other hand. San Francisco reports continued competition for quality loans and cites some reports that credit requirements are being relaxed in order to attract additional business. However, despite the relatively low loan volume in the San Francisco District, many financial institutions show improved net income.

FIRST DISTRICT-BOSTON

Economic sentiment in the First District has a more positive tone than in recent months, although actual results are mixed. Manufacturing sales are good and orders are up at a majority of firms contacted. Retail sales are ahead of last year and generally on plan, but plans have been scaled back. Price pressures have moderated except for steel and copper. Manufacturers have now joined retailers in expressing concern about the tight regional labor market. The outlook is "steady as you go," with most contacts expecting a continuation of current activity levels.

Retail

First District retailers report business in October and early November to be generally satisfactory and within their conservative expectations. Sales are moderately ahead of last year's level, and also better than soft third quarter results. Respondents even expressed optimism that a turn-around in the sluggish women's apparel trade is imminent. Inventories are nevertheless light, reflecting a desire to enter this Christmas season in a lean position. Prices remain relatively stable at both the wholesale and retail level. Profits are consistent with plans, for the most part, as increases in margins and improvements in sales mix offset greater promotional activity and rising labor cost. Wages for retail clerks, in particular, are up 13 to 15 percent from year-ago levels. But despite the prolonged tightness in regional labor

markets, some respondents have been pleasantly surprised by the availability of part-time workers for the Christmas season.

Regional retailers generally expect a good Christmas. But over the longer term, most respondents foresee a sharper competitive environment. One sees a permanent increase in promotional activity while another spoke of an over-built regional retailing sector. Most contacts express a continued interest in building new stores should the right site appear, but they are focussing their capital programs on remodelling, warehouse, and office construction. One retailer found contractors unexpectedly eager to undertake a warehouse expansion; the bids were 15 percent below expectations.

Manufacturing

Most First District manufacturers characterized current business conditions as good, with sales 3 to 20 percent above year-ago levels. The order situation is mixed, however. Almost half of the respondents report that orders are flat or down slightly - with two citing seasonal factors. The other contacts indicate that orders are 10 to 15 percent above last year's levels and for one the order backlog is its highest in several years. Demand for machinery, paper, and aircraft-related products was described as particularly strong. Demand for consumer, defense and computer-related products is less robust. Several contacts mentioned good export growth or reduced import competition.

Inventories are generally reported as "comfortable" although a few manufacturers have increased inventories because some materials such as paper require longer order times. Most First District contacts indicate that materials prices have continued to rise. While manufacturers generally see paper prices stabilizing now or in early 1989, they expect no relief from steel and copper price increases. Although most respondents have recently raised prices on some of their own products, several report that materials

price increases continue to hurt their margins on some lines. Prices on consumer products are set far in advance, for instance, and raising the prices of auto, defense or computer-related products remains difficult.

Employment levels at First District manufacturing firms are flat or up slightly. Almost half of the respondents described labor markets as tight or indicated a need to train recruits. Views on wage pressures were mixed. While some contacts described recent wage increases (of 2 to 4 percent) as "moderate," others are giving more than in recent years. One firm is shifting some functions to the Southwest to avoid offering premium wages.

Capital spending plans are also mixed. While some firms' capital expenditures are substantially above last year's level, others report that capital spending is down slightly. Several respondents that undertook big capital spending programs over the last couple of years expect expenditures for 1989 to be down somewhat. Other contacts foresee an uptick in capital spending; two mentioned plans for new plants.

A majority of contacts foresee sales growth continuing at a "strong" 10 to 15 percent annual rate during the first half of 1989. Others expect a gradual slowing. One respondent, who expects reduced sales, pointed out that his firm can achieve better profits even on the basis of reduced volume because of cost cutting programs already in place. No contact forecast a recession in the first half of 1989. One characterized 1989 as likely to be "boring," but suggested that the country needs a boring year to reduce current imbalances.

Outlook

The New England Economic Project (NEEP), a non-profit organization comprised of businesses, government agencies, and educational institutions, held its semi-annual outlook conference in mid-November. The NEEP forecasts for the six New England states, taken together, call for nonfarm jobs to grow 2.5 percent in 1988 and 1.9 percent in 1989, compared to 2.6 percent in 1987.

Because of continued improvement in the nation's trade deficit and associated increases in business fixed investment, manufacturing jobs in the region are expected to grow modestly in 1989. The region's factory job gains will be concentrated in durable goods industries, especially nonelectrical and electrical machinery. Despite the improvement in manufacturing, nonmanufacturing industries will still account for most of the additional jobs. Nonmanufacturing employment growth will be more modest than in recent years - averaging about 2.2 percent in 1989. The region's unemployment rate will continue to be 2 percentage points below the national average. Personal income growth is also expected to remain stronger in New England than in other regions of the country.

SECOND DISTRICT--NEW YORK

The rate of expansion in the Second District's economy may have slowed somewhat since the last report. The latest purchasing managers' surveys continue to show most firms reporting improved to stable conditions, but a smaller share than in recent reports, and some department stores have recently experienced an over-the-year decline in sales. The pace of homebuilding remains slow for the most part, but a pickup occurred in commercial real estate activity. Commercial and industrial loan demand at small and medium-sized banks in the District has been slow to moderate, though a few loan officers reported some strength.

Consumer Spending

The pattern of sales at District retail stores was quite varied in recent weeks. Two retail chains reported that October sales declined from a year earlier although some improvement occurred as the month progressed. On the other hand, one chain had a large over-the-year gain which was attributed primarily to increased promotionals this year.

Reflecting the differing sales results, reactions were also mixed concerning the level of inventories and the ability to meet sales targets. Those retailers with sales below plan and excessive inventories intend somewhat more aggressive promotionals in the weeks ahead, while others anticipate no change in strategy.

Most of our contacts reported some pickup in sales of women's apparel from the slow pace earlier this year, and some noted that unusually cool weather spurred outerwear sales as well. With regard to the outlook, retailers are moderately optimistic about the upcoming holiday season but generally do not anticipate large over-the-year gains.

Business Activity

Recent purchasing managers' reports suggest some slowing of the District's economic expansion occurred in recent weeks. In both Buffalo and Rochester the percentage of purchasing managers reporting improved business conditions declined, and the percentage reporting a worsening increased. Nonetheless, by far the majority of firms--90 percent in Rochester and 85 percent in Buffalo--continue to report stable to improved conditions, and those in the Rochester survey anticipated little change over the next three months.

Unemployment rates in the District remain below the national average with October readings of 4.2 percent in New York and 3.9 percent in New Jersey. As was true nationally, rates in the District have fluctuated within a fairly narrow range in the past several months. The October-to-October rate decline in New York was virtually the same as the national average, but in New Jersey where last October's rate was already very low, the year-to-year decrease was slight.

Few new major projects were announced in the District since the last report. However, western New York was buoyed by some recent developments. Two "upscale" New York City department stores announced plans to make their Buffalo area debut in a new shopping mall now under construction there--further indication of Buffalo's comeback from its earlier loss of several manufacturing firms. In addition, a major supermarket chain plans to open three large "superstores" in Buffalo and Niagara Falls.

Residential Construction and Real Estate

The pace of homebuilding in the Second District remains slow for the most part though some upstate New York communities continue to report strength. In the Fort Drum area, for example, builders are busy on both military and nonmilitary housing and activity around Buffalo exceeds the year-earlier level. In most of the District, however, activity has been subdued, with home prices remaining high and

the resale market slow as a result. Several plans for affordable and retirement housing have recently been unveiled, though, and these could help reactivate the housing market to some extent next spring.

A pickup occurred in District commercial real estate activity recently. During October the midtown Manhattan market experienced its highest level of leasing activity since July 1986, and downtown Manhattan also registered more strength than had been seen since the stock market crash. The pace of leasing activity has also been moderate to good in other parts of the District. However, vacancy rates have shown little change because of a sizable supply of office space coming on line in many areas.

Financial Developments

Commercial and industrial loan demand at small and medium-sized banks in the Second District is currently reported as slow to moderate, though a few loan officers report some strength. Those who have witnessed a slackening attribute it to seasonal factors and to concern about the economy, particularly the budget and trade deficits. One officer stated that in an environment of uncertainty, borrowers are reluctant to take on additional debt. Most respondents said that the increased level of interest rates in recent months has had little effect on business loan demand. The bankers anticipate that conditions at their banks will hold constant into early next year. Business loan portfolios at these banks currently consist almost solely of short- to intermediate-term loans, the definition of which varies among respondents, but is generally less than five years. Recent changes in the mix of short- versus long-term loans favored the former. All of the respondents stated that their banks had not purchased any of the merger and acquisition loans which are now on the secondary market. One officer commented that the pricing of these loans was not attractive enough to entice smaller banks to learn about the unfamiliar new packages.

THIRD DISTRICT - PHILADELPHIA

A mid-November survey of business conditions in the Third District indicates continuing growth in most sectors. Manufacturing was posting its tenth month of expansion, with growth running at about the same pace as it has since spring. Retail sales were rising modestly, and a slight pickup in year-to-year gains first noted in October was continuing. Automobile sales in October and early November were up from the same period last year for domestic makes but down for imports. Business and personal lending continue to rise, although the pace of growth appeared to be easing in recent weeks.

The outlook in the Third District business community is for more growth, but with some reservations about the extent of further gains over the winter. Manufacturers see the current expansion continuing, but optimistic forecasts are not as prevalent as current reports of improvement. Nevertheless, capital spending plans are fairly strong, on balance, and firms scheduling additions to plant and equipment are looking to boost capacity by 5 to 20 percent over the next six months. Retailers forecast fiscal fourth quarter sales of about 3 percent above last year, in real terms, but express more than the usual amount of uncertainty about the outlook. Bankers see signs that growth in loan demand is slowing, but they say money market conditions could push lending rates up nevertheless.

MANUFACTURING

The region's manufacturing sector is still on an upward track, according to the November Business Outlook Survey. Among firms polled for the survey, 34 percent said business was picking up from October while only 6 percent said business was off. Manufacturers of nondurable goods reported somewhat better

conditions than did durable goods makers, but both sectors showed improvement month-to-month.

Nearly all indicators of industrial activity were signaling growth in November. New orders and shipments were rising, order backlogs were edging up, and delivery times were being stretched somewhat as local manufacturers posted the tenth consecutive month of growth. Employment continued to gain as well. Twenty-four percent of the firms participating in the November survey were adding to payrolls while only 11 percent were cutting back.

Upward price pressure is still being reported. Among November survey respondents, 61 percent noted rising input costs and 32 percent indicated they were raising the prices of their own products. Looking ahead, 66 percent expect to pay higher prices for the goods they will buy over the next six months and 60 percent intend to charge more for the goods they make.

Area manufacturers see good business conditions lasting at least through the winter. Thirty-eight percent of the firms contacted in November expect more growth over the next six months while 17 percent see signs of a slowdown ahead. Overall, survey participants forecast increases in employment, new orders and shipments, although they anticipate an easing in order backlogs.

Local manufacturers' capital spending plans call for increases, on balance, for the next six months. Thirty-six percent of the November survey respondents intend to step up investment while only 13 percent will cut back. Planned increases, for both modernization and capacity expansion, are prevalent in the chemical, textile, and nonelectrical machinery industries. Some area firms in these industries have scheduled investment projects that will boost capacity in a range of 5-20 percent at certain plants over the next six months, although most describe the amount of the increase in their capital expenditures as modest.

RETAIL

Third District retailers report that sales were better than expected in October and a good pace was being maintained in the first half of November. Sales of women's apparel appear to be on the rebound after a long period of weakness, but merchants say price increases are coming that could dampen shoppers' enthusiasm. Store officials indicate that inventories are in line with current and projected sales, and they say that discounting, while widespread, is in accordance with planned pricing strategies.

Area merchants are reluctant to predict the outcome of the Christmas shopping season because the competitive situation in the region is in flux, with major chains still working out their consolidation moves. Nevertheless, most retailers anticipate a satisfactory season, although expectations are that the year-to-year improvement in 1988 will be less than in the past few seasons. The consensus forecast is that fiscal fourth quarter (November-January) sales will be around 3 percent higher, in real terms, than the year-ago period.

Automobile dealers in the region report mixed results for October and early November. Domestic makes are selling above last year's pace but imported cars are selling below the rate of a year ago. Dealers expect sales to be good through the end of the year, after accounting for the usual winter slowness. However, dealer inventories have inched up lately and there could be a step-up in manufacturers' rebates and dealer discounts to boost sales in December.

FINANCE

Third District bankers contacted in mid-November described loan growth as good, but easing in recent weeks. Total loan volume at major Third District banks grew at an annual rate of 12 percent in October, but bankers say most categories of lending have been growing somewhat more slowly since. Commercial and industrial lending in October was up 18 percent from the year-ago period at

major banks but growth appeared to be declining in November. Lending officers say requests for commercial credit are continuing at a high rate, but the average credit quality of business loan applicants has fallen below standards, and growth in loans booked is slackening as a result. Real estate lending, while still expanding strongly, continues on its year-long trend of slowing growth. The rate of increase in consumer loan volume eased somewhat in October, but bankers said recent promotional efforts were reviving the pace of growth.

While deposits at major banks have been growing at a fairly steady 6 percent annual rate since mid-year, bankers interviewed in mid-November said their costs of funds have been rising. According to some, current money market conditions make increases in bank lending rates likely.

FOURTH DISTRICT - CLEVELAND

Summary

The Fourth District economy continues to expand. Manufacturing output is growing at close to the national rate, with particular strength in nonelectrical machinery and primary metals. Purchasing managers report fewer price increases, as the backlog of orders has fallen and new orders have risen only slightly. Service jobs lead recent employment gains, and unemployment rates are only slightly above the national rates. Retail sales and loan demand continue to grow at moderate rates.

Retail Sales

Retailers report moderate gains in sales from a year ago. Home electronics products and apparel are reported to be selling well, while other general merchandise is lagging. Although retailers are posting price increases cautiously, they are relying much less on discounting to move inventory than they did a year ago after the stock market downturn. Some retailers expect price increases in hardware, kitchenware, and apparel because suppliers of these products are operating at capacity.

Domestic auto dealers report that sales are about the same as a year ago. The current pace of auto sales has been sustained without resorting to special incentive programs, which were used extensively a year ago. Few 1988 models remain in dealers' inventories, and dealers indicate that inventories of 1989

models are in line with expected sales. Popular imported cars are selling well, although not as briskly as a year ago.

Labor Markets

Employment in Ohio continues to grow at a moderate pace. Total employment increased 2.1 percent over the last year, which marked a slightly slower rate than in previous months. Increases in service jobs, particularly business services, accounted for most of the employment gains. Manufacturing employment showed only slight increases. Despite the slightly slower overall employment growth rate, unemployment rates throughout the District remained at or slightly above the national rate of 5.3 percent. Shortages of skilled workers are reported in several metropolitan labor markets.

Average hourly earnings of manufacturing workers have been very stable, despite the recent upturn in average weekly hours from 42.3 hours to 42.5 hours. According to two separate surveys, area compensation managers are budgeting about the same level of wage and salary hikes for the coming year (4.6 percent) as they granted in 1988. Average pay increases range from a low of 3.4 percent for unionized production workers to almost 5 percent for executives and managers. Manufacturers reported lower expected increases than did nonmanufacturing companies.

Manufacturing

Backed by strong capital-goods demand and rising exports, manufacturing production in Ohio continues to advance at a rapid pace. The gains have come

despite some softness in demand for consumer durables, and particularly in auto and truck production. According to the Federal Reserve Bank of Cleveland's Ohio Manufacturing Index, Ohio production rose 5.2 percent from a year ago, roughly the same magnitude as output gain at the national level (5.9 percent). Producers of nonelectrical machinery led the advance, up 11.6 percent over the past year. Also posting large gains over the year were electrical machinery and primary metals, up 6.7 percent and 8.8 percent, respectively. Production of transportation equipment, which accounts for roughly 20 percent of Ohio's manufacturing output, has fallen to its lowest level of the past three years--down 1.9 percent over the year.

Purchasing managers report that, while production continues to increase, the backlog of orders has fallen and new orders are up only slightly. In addition, vendor delivery performance continues to improve, indicating that vendors have more time to service their accounts.

Commodity, service, and equipment prices are still increasing, but less quickly, according to purchasing managers. For the first time in several months, less than half the respondents reported general commodity price increases.

Banking

District loan demand continues to be moderate. Total loans outstanding at large banks grew at an annual rate of 7 percent from mid-September to the beginning of November. Although this growth is considerably less than the

double-digit pace registered over the same period a year ago, it represents a slight pickup from the loan growth experienced during the summer months. Real estate loans, which increased at a 13 percent annual clip, accounted for a large share of the loan growth. Business and consumer loans grew at annual rates of 3 percent and 4 percent, respectively.

FIFTH DISTRICT-RICHMOND

Overview

District economic activity varied by sector during the first half of November. Retailers reported lower sales, and homebuilders said their construction was down more than seasonally. Bankers reported that deposit and loan activity was flat. Manufacturers, however, reported moderate growth in activity, and representatives at District ports expect exports to grow more than imports in November. Office vacancy rates held steady or declined in some District cities, and in the District's agricultural sector, tobacco farmers enjoyed a good year.

Consumer Spending

Retail sales in the District during the first half of November apparently were down from the last half of October. Slightly over half of the respondents to our regular mail survey reported declines in sales, while the other respondents were about evenly divided between those who experienced increases and those who experienced no change in sales. Department stores reported declines in the sales of big ticket items. Inventories rose at both department stores and new car dealerships. Most department store managers felt their inventories were too high, while most car dealers said their inventories were about right. The majority of retailers expect sales to increase in the next six months over the comparable period a year ago.

Manufacturing

According to our regular mail survey, manufacturing activity expanded moderately in late October and early November, at about the same pace as in September. Responses indicating increased activity outnumbered those indicating declines; about half of those surveyed reported no change. Inventories of finished goods and materials were generally unchanged. Half of

the respondents said their inventories were at proper levels, while 38 percent said they were too high. Prices of manufacturers' materials apparently continued to rise at about the same pace as in September.

District manufacturers have become more optimistic about the growth of general business activity in the nation. In our previous two surveys, manufacturers who expected decreases in national activity exceeded the number who expected an upturn, but in our latest survey, the respondents who expect some change in national activity were evenly split between those expecting increases and those expecting decreases over the next six months. With regard to the outlook for their own businesses, most respondents believe their shipments will hold steady or rise in the next six months.

Port Activity

Based on port activity through the first half of November, representatives from the three major District ports--Baltimore, Norfolk, and Charleston--said they expect increased activity through November compared with October. Increases in exports were cited as responsible for the current and expected increases in activity. Imports in November are expected to rise only slightly from October at Norfolk and remain unchanged at the other two ports. Our District port contacts indicated that the ratio of exports to imports was higher now than a year ago.

Construction

A telephone survey of District homebuilders indicated that new construction slowed more in November than is usually expected for this time of year. Well over half of the respondents reported a drop-off in speculative building. Builders said, however, that demand was still fairly strong, and most anticipate stable markets for single-family homes for the next several months.

Another of our telephone surveys indicated that office vacancy rates in several large District cities either remained steady or edged down in the third quarter from second quarter levels. The office vacancy rates in the cities surveyed ranged from 13 percent in Baltimore to 21 percent in Norfolk. Vacancies in the Raleigh-Durham area have recently dropped below 20 percent, but more space is slated to open there soon.

Financial

The responses of bankers we telephoned indicated that deposit and loan activity was essentially flat in the past three weeks. For the most part, industrial loans on the books in mid-November were reported as unchanged from mid-October as well as from a year ago. The few institutions with increases in industrial loans attributed the rise to stronger demand rather than more liberal lending policies, while the institutions that experienced declines cited more conservative policies. Most bankers expect increased demand for industrial loans in 1989.

Agriculture

The District's markets for flue-cured tobacco closed for the season last week, and final figures indicate that it was a good year. District production, which is close to 90 percent of the national total, was up 15 percent over last year, and prices averaged about 2 percent higher. Production of burley tobacco was about even with a year ago. The cash value of all 1988 tobacco production in the District is estimated to be about \$150 million above a year ago.

SIXTH DISTRICT - ATLANTA

The strength of the current economic expansion is reflected in the southeastern economy, although pressure on prices is being partially countered by capacity expansion and weaker domestic demand for some products. Several makers of producer goods like ball bearings, air-powered tools, custom-made machinery, paper board, and metal buildings report that they have been running virtually at 100 percent of capacity. They are currently trying to expand capacity by either adding new space, replacing old equipment with modern machinery, or adding extra shifts of workers. In general, capital investment in the District appears strong and the demand for capital goods produced in the region also seems robust.

Although they are operating near capacity, these manufacturers seem to be satisfied with their ability to keep up with deliveries to their customers. Some report that their suppliers are delaying shipments, while others are having no trouble with input delays. Input prices show no consistent movements, ranging from no increase to an increase of about 5 percent over the year for most products. The prices of metals have increased considerably more. Some substitution of domestic for imported inputs has taken place, although imports are not used to a great extent by southeastern manufacturers. Most point out that wages have increased between 4 and 6 percent over the year; expected increases for 1989 are about the same. Manufacturers in Tennessee and Alabama have had little trouble hiring skilled workers; those reporting difficulty in finding skilled workers are located in rural areas of Mississippi or southern Georgia and Alabama, areas that historically have had fewer skilled workers. Many report pressures on the cost of employee benefits, especially health related ones.

The localized tightness in some labor markets, supplier delays, and input cost increases have yet to result in any consistent increases in final product prices. The manufacturers we contacted say they have not increased their prices because domestic competition is strong. Inventories of materials are lower than usual for these

manufacturers, although they seem to prefer to purchase these inputs as new orders arrive rather than maintain larger inventories.

The chemical industry centered in Louisiana is also running at high capacity levels. Some contacts report that there are "bidding wars" for skilled labor. Supplies of ethylene and propylene are tight, and chemicals used in the textile industry, especially those used in rayon, are becoming more expensive. Strong export demand is keeping chemical prices up.

The textile and apparel industries are concentrated in the Southeast, and there has been some retreat from the high levels of capacity utilization seen earlier this year. The weakness seems to be centered in those plants heavily involved in the production of apparel fabrics. Competition from imported apparel is still strong, while domestic demand is showing some weakness, and this has caused some domestic producers to shift out of apparel fabrics and into products like commercial carpets, towels and bedding, and infant clothing (perhaps a result of the baby-boom echo). Except for carpets, weaker demand is preventing increased production costs from being passed on to consumers. The shift in production has been accompanied by the closure of older plants and the expansion or construction of new plants. Labor saving spinning and weaving machines are being installed. Skilled workers, however, are reportedly in short supply, and wages have been rising.

Strong export demand has been offsetting weak domestic demand for several southeastern industries. Steel producers note that foreign demand for steel pipe has been strong. The weakness in domestic purchases stems from a decline in orders from the oil and gas industry, particularly for replacement pipe for older gas pipelines. A producer in Alabama has suggested that steel supplies are plentiful compared to the tight markets earlier this year, with the price of scrap steel now showing some decline. Modernization and construction of new steel and aluminum plants in Alabama are underway. They are technologically state-of-the-art, and while they will expand capacity substantially, they will not result in great employment gains. Appliance manufacturers have reported

increases in the prices of steel and aluminum. Because of weak demand owing to the slowdown in the housing market, they have not been able to raise their prices and cover their higher costs. In trucking, however, these increases seem likely to show through. The industry is expanding, and the demand for carriers is brisk.

Foreign demand for hardwoods is supporting the price of raw timber and logs. Japan is a large buyer of hardwoods, and the United Kingdom has been importing hardwoods for flooring. Demand from domestic furniture makers has weakened, resulting in some price declines for certain grades of finished hardwood. The earlier retreat in housing starts has weakened the market for construction grade softwoods. Inventories are increasing as producers hold on to output in hopes of receiving a better price later. Lumber producers do not expect exports to help much in 1989, partly because of competition with Canadian exports and higher interest rates in the United Kingdom that have slowed the housing market there.

Although residential, office, and retail construction is slow in the District, industrial and warehouse construction has been expanding. The strength in exports has resulted in new warehouse construction in Miami and Savannah. Speculative industrial building has been going on in Birmingham, Mobile, and Nashville, where low vacancy rates have encouraged new development. One respondent felt, however, that in Atlanta overbuilding now extended into the industrial and warehouse sector as well as the commercial market. The prospect of more foreign companies moving to the Nashville area has spurred construction there as well.

SEVENTH DISTRICT--CHICAGO

Summary. Business activity in the Seventh District continues to expand, though several indicators suggest at a less rapid rate than earlier. Chicago purchasing managers report somewhat slower, but still brisk, expansion in October. Indianapolis purchasers indicate stronger growth. Motor vehicle makers are working overtime at several plants to meet demand, but cutting back elsewhere because of slow sales of some models. Markets for heavy equipment and steel remain relatively strong. Further growth is expected next year in capital goods. Construction activity is holding up well, but some slippage is expected in 1989. This year's harvest of major crops is virtually complete in most of the District, and drought losses appear slightly less severe than expected earlier.

Labor Markets. Increases in payroll employment in the District states during the third quarter were slower than in the first half. Unemployment in the District, higher than the nation throughout the 1980s, has fallen nearly to the national rate. Labor markets have tightened in various regions in the District. Iowa, which experienced sizable outmigration earlier in the decade, now reportedly faces shortages of skilled blue collar and clerical workers.

Purchasing Managers. A survey of Chicago-area purchasing managers showed continued fairly strong expansion in business activity through October. However, several measures were less robust than in earlier months. Production and backlogs continued to rise but less sharply. Lengthening delays in obtaining deliveries were also less common. Those paying higher prices continued to outnumber, by a wide margin, those paying less (59

percent to 2 percent) but price increases were more widespread in prior months since July 1987. In contrast, an October survey of Indianapolis purchasing managers, conducted quarterly, suggests stronger expansion in the latest period.

Motor Vehicles. Car and truck sales continue at high levels. However, the somewhat slower pace of car sales in October than in earlier months and ambitious production plans have raised concerns that excessive inventories may accumulate. Manufacturers' sales incentives, now offered continuously, may be enhanced if this occurs. A Michigan plant assembling a slower-selling car model will reduce output and lay off 1,000 employees in January. However, other plants, particularly truck plants, are running flat out and resorting to overtime to meet demand.

Machinery and Equipment. Markets for machinery continue strong, overall, though demand is softening for some types of equipment. Further increases in spending for capital equipment, particularly heavy capital goods, are considered likely in 1989, with growth expected to be less rapid than this year. Investment is particularly strong in chemical process industries, including petrochemicals and paper, mainly in "debottlenecking" or "incremental" additions to existing capacity. Sizable investments are also reported in steel mills; in printing plants producing newspapers and wrapping paper; and in food processing plants, including bakeries and breweries. Some softening is reported in communications equipment and electronic components.

Steel. Demand for steel remains strong. Industry shipments in 1988 are likely to outpace last year by 9 percent. Early indications for 1989 suggest a continued high level of steel purchases by motor vehicle, appliance, and machinery makers. Shipments from steel service centers have set records.

Upward pressures on steel prices have eased, after sharp increases earlier, but could resume next spring when the industry may again be unable to meet peak seasonal demands.

Construction. Construction activity in the region appears to be holding up relatively well, stronger than expected earlier, but is likely to decline from recent levels. Contracts for nonresidential buildings in the five District states, for 9 months, were 1 percent below a year earlier (measured in square feet of floor space). Residential contracts were 9 percent below last year, indicating that future building activity is likely to fall. However, shipments of some building materials, an indicator of current construction activity, have risen this year. Shipments of gypsum board to the District states were 3 percent higher during the first 9 months than a year earlier. Year-to-date cement shipments to the East North Central states were also 3 percent higher. Building activity is vigorous in the Chicago area, particularly Loop office construction, industrial building, and homes.

Agriculture. Corn and soybean harvests are nearly finished in most District states. The Michigan harvest, slowed by recent rains, is about three-fourths complete. Although badly hurt by the drought, yields are slightly higher than earlier estimates. Corn production in District states is expected by the USDA to be 41 percent below last year's crop, and soybean production is estimated 29 percent lower--both sharper declines than nationwide.

EIGHTH DISTRICT - ST. LOUIS

Summary

Weakness in many sectors of the District economy has continued in recent months. Payroll employment rose slightly, largely the result of gains in manufacturing. Construction activity continues to weaken as homebuilding declines. A drop in consumer lending has caused overall loan activity to fall. Agricultural conditions, on the other hand, are improving because of warm, wet fall weather.

Employment

Unemployment rates in most District states increased slightly in the third quarter. Payroll employment continues to grow slower in the District than in the nation: in the third quarter, it rose at a 0.2 percent seasonally adjusted annual rate in the District compared with a 3.3 percent rate for the nation. In contrast to other states in the region, Kentucky's recent employment growth has been moderate: payroll employment in the state rose at a 2.7 percent rate in the third quarter.

Employment in all nonmanufacturing sectors grew slower in the District than in the nation in the third quarter. Employment in the region's services and wholesale/retail trade sectors declined slightly in both the second and third quarters after rising in every previous quarter of the recovery.

District manufacturing employment grew at a 2.7 percent rate in the third quarter, after declining at a 2.8 percent rate in the second quarter. In comparison, national manufacturing employment increased at a 1.4 percent rate during the third quarter, after growing at 2.3 percent rate during the

previous three months. The District's recent growth was concentrated in factories producing electrical equipment, nonelectrical machinery, chemicals and transportation equipment. Approximately 2,100 workers--many of whom had been laid off since November 1987--were recalled to a St. Louis area auto assembly plant in September. Increasing orders for motor vehicle parts led to 1,100 additional jobs over the last 12 months in Arkansas.

Consumer Spending

District retail sales have been similar to those of a year earlier, after adjusting for inflation. St. Louis retailers report slightly slower sales volumes than a year earlier with particularly sluggish sales in general merchandise stores. Sales in Memphis recently have softened after moderate gains during the summer months. In contrast, retail jobs in Louisville, as well as elsewhere in Kentucky, have grown substantially in response to moderate sales growth.

Department stores throughout the District generally expect real sales during the upcoming holiday season to be only a few percent above last year's level and have accordingly kept inventories slim. Numerous pre-holiday sales already have appeared, and widespread price discounting is expected throughout December.

Construction

The real value of District building contracts declined 1.5 percent in the third quarter and was 7 percent less than in the third quarter of 1987. Contracts for District nonresidential construction projects rose 3.8 percent in the third quarter while residential contracts fell 6.1 percent after adjusting for inflation. Contracts for both sectors were below year-earlier levels. During the third quarter and throughout the current recovery, regional residential construction growth has been weaker than the national rate. The expansion of District nonresidential construction, however, has exceeded the national average.

Banking

Total loans at large weekly reporting District banks declined at a 1.3 percent annual rate in the three months through October, down from a 2.5 percent rate of increase in the same period last year. The overall decline was due primarily to a 17.4 percent drop in consumer loan volume. For the same three-month period in 1987, consumer loans expanded at a 6.3 percent rate. Commercial loans also declined during the recent three-month period. Real estate lending grew more slowly than a year earlier.

Agriculture

Agricultural conditions continue to improve. Late-planted soybeans in southern portions of the District have benefited from warm, wet fall weather and are producing above-average yields. Crop production in these states accordingly is being revised upward. The rain also is benefiting the recently planted winter wheat crop. The District's cotton crop, however, is being damaged by the rain, and below-average yields are now anticipated.

The rain also has helped to recharge dry soils and has improved pastures, a development that will allow livestock producers to carry larger herds through the winter. This should alleviate some of the pressure on red meat prices that had been feared for next year had livestock producers been forced to reduce herds further. Because of the availability of storage space and the long harvest period, no grain transportation difficulties have been encountered.

NINTH DISTRICT-MINNEAPOLIS

Ninth District Economic Conditions are good. Unemployment rates have not changed much. Consumer spending has stayed at satisfactory levels and consumer price increases continued to be moderate, but some raw material prices have increased sharply. Conditions in resource-related industries continued to improve and those in agriculture remain largely unchanged.

Labor Markets

The employment situation has been good throughout the district. Between August and September, Minnesota's unemployment rate dropped two-tenths of a percentage point to 3.4 percent; this is lower than the 4.2 percent rate of a year earlier. A director notes increased turnover of the work force in the Twin Cities Metropolitan Area, particularly in jobs paying less than \$6/hour, suggesting that labor markets are tight. South Dakota's September unemployment rate at 3.5 percent edged up modestly from the year ago rate of 3.4 percent. North Dakota's unemployment rate rose to 3.9 percent in September from 3.3 percent a year earlier. In Montana the unemployment rate in September was 4.7 percent, down a full percentage point from the previous year. However, the labor force was 3 percent smaller than a year earlier. In the Upper Peninsula of Michigan, the unemployment rate was 6.3 percent in September, compared to 7.3 percent a year ago.

Consumer Spending

Consumer spending on general merchandise continues to increase and retailers generally anticipate good Christmas sales. Inventories are at acceptable levels. The Upper Peninsula, particularly, reports strong sales. Consumer loans from banks in that region are up 31 percent in the first ten months of this year from a year ago.

Motor vehicles are generally selling well, though there is reported to be some shift from new to used car sales, particularly in the Dakotas. One domestic line reports that car sales were up 36 percent in October from the depressed levels of a year ago. Truck and van sales are particularly good and manufacturers report difficulty in meeting demand. Recreational vehicles are selling exceptionally well and the bigger and better 1989 models are in heavy demand.

Housing activity is generally lower than a year ago. The number of new housing permits issued in Minnesota in September was down 35 percent from a year ago. Reflecting recent strength total housing sales in the Twin Cities area in October were up 33.4 percent from a year ago. However they were down 13.2 percent for the first ten months of the year compared with the same period last year. Housing activity is good in some parts of the district. The Upper Peninsula reports that new mortgages issued by banks are at record levels. Mobile home sales are reported to be higher in South Dakota than last year.

Tourist spending continues to be strong, particularly in the Upper Peninsula which reports the number of tourists was 10 percent higher thus far this year than last year. Ski resorts anticipate an excellent year due to the early and heavy snowfall in many areas. An initiative to allow limited gambling in the city of Deadwood, South Dakota has passed and is expected to be approved by the Legislature. Proponents hope this move will attract more tourists to that historic city.

Prices

Consumer price increases continued to be moderate in the district. However, many agricultural prices are reported to be up sharply over last year. Corn prices are up to \$82 per ton from about \$55 per ton at this time

last year. Some raw material prices are also up sharply. For example, aluminum prices are up to \$1.10 per lb. from \$0.80 per lb. a year ago. Copper prices are up to \$1.40 per lb. from \$1.10 per lb. a year ago.

Resource-Related Industries

Conditions are generally reported to be excellent in the district's resource-related industries. The lumber industry in Montana had an outstanding year. Productivity improvements in this industry over the last five years have reduced the work force by about 25 percent even though output is higher. Mining continues to be a bright spot in Montana with a second platinum mine expected to open in 1989. However, there are only 4 oil rigs now operating in the area. Gold mining activity in South Dakota is also reported to be good. One observer described the forest industry in the Upper Peninsula as "going gangbusters." Furniture plants in the area have back orders ranging from 6 weeks to 3 months. New copper smelters are being considered for construction in the area.

Agriculture

Agricultural conditions are fair as the effects of the drought recede. However, many areas still report low topsoil moisture. Montana reports that topsoil moisture is 60 percent below normal and subsoil moisture is 65 to 70 percent below normal. Only 20 percent of the topsoil in Minnesota is reported to have adequate moisture. Early winter precipitation seems essential for a good winter wheat harvest. Winter wheat planting in Montana is about 85 percent completed. However, lack of snow cover raises the possibility of significant crop loss. An estimated 99 percent of Minnesota's corn crop has been harvested compared to a normal average by this time of 92 percent. The sugar beet crop is good in most of the district.

TENTH DISTRICT - KANSAS CITY

Overview. The pace of economic activity in the Tenth District remains relatively slow. Many manufacturers report high capacity use rates and some have had problems finding skilled labor. Retailers report some improvement in sales recently, but automobile sales are steady to lower. Housing activity remains slow, with weak sales and high inventories of homes. Lower crude prices are leading oil companies to reevaluate their drilling programs, but the number of active drilling rigs was little changed from August to October. Loan demand at district commercial banks has changed little, while deposits have increased slightly. Solid farm incomes in spite of the drought are being reflected in an active market for new and used farm machinery and in strong farmland prices.

Retail Sales. Most respondents note a general improvement in retail sales over the last three months. Prices are generally steady to slightly higher, with most retailers reporting price adjustments primarily in response to wholesale price increases. Inventory levels are typically satisfactory, although some respondents report continuing efforts to reduce their stocks. Retailers are cautiously optimistic about future sales. With no "Black Monday" effect, expectations for holiday season sales are more optimistic than last year at this time. Moderate gains from last year's sales levels are expected.

Automobile Sales. Most respondents report steady to lower automobile sales over the past month, and inventories are reported to be expanding. Adequate dealer and customer financing are generally available. Little change in sales is expected in the upcoming year.

Manufacturing. Most respondents report that materials inputs prices have risen moderately compared with a year ago. Materials are generally available,

but some lead times have lengthened. Many respondents have been trimming their inventories but now are satisfied with current levels. Capacity use rates vary widely across industries. However, many firms are operating near full capacity, and some firms report problems in finding skilled labor.

Energy. Weaker oil prices are causing oil companies to reevaluate their drilling programs. October drilling activity was down almost a fourth from a year ago, but the average number of active drilling rigs in the district rose slightly from 261 in August to 265 in October. One respondent noted that exploration and drilling in Oklahoma has held up surprisingly well recently, partly due to significant gas discoveries in the eastern part of the state.

Housing Activity and Finance. Activity in the housing sector remains sluggish. Homebuilders in the Tenth District generally report that housing starts are down compared with last year and stable to slightly higher compared with last month. Multifamily construction continues to be the weakest component. Most respondents report lower sales of new homes, and home inventories are considered to be fairly high.

Most respondents at Tenth District saving and loan institutions report that savings inflows are little changed either from a year ago or from a month ago. Virtually all respondents expect little change in savings inflows in the near future. Mortgage demand has slowed recently, partly due to seasonal factors. Mortgage interest rates have remained steady or increased slightly recently, and are expected to increase further in the next several months.

Banking. District commercial banks report little change in loan demand over the past month. Demand for commercial and industrial loans and consumer loans was up slightly at a few institutions, while demand for most other types of loans was either constant or down slightly. None of the respondents changed their prime rates in the past month, and virtually none of them expect

any change soon. Consumer loan rates were also unchanged at most of the banks surveyed, and no change is anticipated in the near term. The behavior of deposits was more variable. On average, deposits increased somewhat at district banks, with greatest strength in large CDs and small time deposits.

Agriculture. The district's fall harvest indicates that the 1988 drought was generally not as severe in the Tenth District as elsewhere. The drought's effect on crop yields also varied widely across the district. Although a return to normal weather patterns is likely for the 1989 growing season, the drought's lingering effects on next year's crops remain of concern. If depleted soil moisture is not replenished, 1989 crops will be especially dependent on timely rains during the growing season. Soil moisture and autumn rainfall generally have been adequate for the early development of the recently planted winter wheat crop. But low soil moisture reserves are still of concern for corn and soybeans in northern Missouri and eastern Nebraska.

Most ranchers are expected to maintain their herds through the winter months, in spite of high prices for drought-diminished forage supplies. Grazing of the winter wheat crop's early growth has eased demand for tight supplies of other forages. But high feed prices are still likely to limit any significant expansion in cattle herds despite currently high cattle prices.

The drought apparently has had little effect on agricultural credit conditions in the district. Most district lenders expect strong farm incomes and little change in loan repayment rates. Solid farm incomes are already being reflected in an active market for new and used farm machinery and in strong farmland prices. On balance, the 1988 drought appears to have had little adverse impact on district farmers or their lenders. And drought-diminished crop inventories could brighten the farm outlook for the year ahead.

ELEVENTH DISTRICT--DALLAS

The District economy continues to perform sluggishly. Growth in demand for manufactured goods is modest. Retail sales expansion is slight. Auto sales are down. In construction, contract values remain above levels for the first half of 1988, but employment continues to fall. Weakened oil prices have reduced District oil and gas drilling. Drought is becoming a more acute problem for agriculture.

Although reports vary greatly across industries, respondents in the District manufacturing sector generally note modest growth in sales. Among producers that sell both nationally and internationally, foreign sales are generally cited as growing faster than domestic sales. This distinction was made by firms across a broad spectrum of products including paper, nonelectrical machinery, and electronics. Electronic equipment manufacturers note some sluggishness in sales overall, and particularly in semiconductors, but they say that their export sales are still growing. Among computer-related manufacturers, consumer product sales are soft, while demand for business equipment remains fairly strong. Energy-related machinery producers say their drilling-related sales are falling but that they anticipate rising marketings to petrochemical producers over the next year. A number of chemical producers continue to note that their sales are high and that they are operating at peak capacity. Demand for manufactured products linked to the construction industry, including lumber and wood and stone, clay, and glass, is generally soft, but a number of producers say their sales are no longer falling. After

strong growth in the demand for paper products during October, a lull in sales is apparent in November.

Patterns of retail sales growth vary widely across the District, but are reported as more stable than earlier this year. Respondents say that sales are strong and growing in Houston, San Antonio, and in the border communities. Along the border, a declining real value of the dollar has made U.S. goods more attractive to buyers from Mexico. By contrast, demand for retail merchandise is sluggish in the Dallas/Ft. Worth area and in Austin.

Reports are fairly consistent across the District that auto sales have been soft lately. In Houston, where reports had been positive in recent months, renewed weakness in sales is attributed to customer concerns over oil price instability. In Dallas/Ft. Worth, respondents link poor sales to the overall sluggishness of the area economy. Despite recent softness, sales in Houston are significantly higher than a year earlier. In Dallas/Ft. Worth, sales are unchanged from last year.

District construction activity remains somewhat above levels for the first half of 1988. Nonresidential contract values have shown little movement over the year, while residential values have expanded modestly since March. Nevertheless, after increasing four consecutive months, a three-month moving average of the value of construction contracts decreased in September. In September, both residential and nonresidential contract values declined in all three District states. District construction employment continues to decline, although at a somewhat slower pace than at the beginning of this year. Residential building permits have been flat recently.

Oil and gas drilling continues to slide in the face of oil prices that have remained below \$15 per barrel for several months. The District rig count has fallen 17 percent since May and employment in some energy-related industries has recently begun to fall. After inching up in every month from February through August, Texas employment in oil and gas extraction declined markedly in September. Respondents say that declines in well permits and a weak outlook for oil prices suggest that drilling will remain weak in the next few months. Reports of cutbacks in drilling plans are widespread.

Drought is becoming a more acute problem for District agriculture. At the end of October, the geographic distribution of drought conditions was about the same as in early August, but drought intensity had increased. In some areas, as much as one-third of an average year's additional rain is needed to return soil moisture to normal levels. County extension agents report that many ranges and pastures are bare. Without significant rainfall this winter, the cost of supplemental feeding may threaten the profitability of cow/calf operations in high-drought areas.

Nevertheless, some farmers are benefitting from the dry weather. For Texas High Plains cotton producers the warm, dry weather of late October and early November has increased yields by as much as 10 percent. The national effects of the drought have resulted in year-over-year increases in prices paid Texas crop growers of 9 percent. Prices paid to Texas livestock producers are up 11 percent. These price increases signify losses to feedlot operators, however, because the cost of purchasing and feeding a cow now exceeds the price of fattened cattle.

TWELFTH DISTRICT — SAN FRANCISCO

Summary

The Twelfth District economy continues to post healthy economic growth. Although respondents to this Bank's Business Sentiment Survey indicate that their expectations about the national economy continue to deteriorate, most paint upbeat pictures of conditions in their industries and regions. Increases in wages and prices are noted for a wide range of products and industries, while recent price decreases have occurred only in a few sectors. Although consumer spending has been lackluster in recent months, manufacturing activity continues strong. In the forest products industries, demand for lumber and plywood has fallen slightly, while capacity constraints are easing in paper production. Gold mining activity continues strong in Nevada. The pace of construction and real estate activity varies widely within the District, with strength noted in California, Washington, Oregon, and Nevada; markets in Arizona, Alaska, and Utah remain weak. Financial institutions continue to report stiff competition for quality borrowers, but industry profits appear to be holding up well.

Business Sentiment

Respondents reported further weakening in their expectations regarding GNP growth during the next year. In the November survey, 53 percent anticipate that next year's growth will be weaker than 3 percent, compared with 43 percent in October and only 34 percent in September. Less dramatic weakening in expectations was noted in business investment, consumer spending, and the trade deficit. Respondents indicated that their expectations about housing starts during the next year have improved somewhat.

Wages and Prices

Reports suggest varying degrees of upward pressure on wages and prices. Structure adjustments for wages and salaries are expected to be close to 5 percent in most cases, which represents a slight up-tick from the 4 to 5 percent range earlier this year. Some note dramatic price increases. For example, one respondent notes price increases of 10 to 14 percent during the past quarter for such "big-ticket" items as large generators and steam boilers. Others report more modest, but also more widespread, increases. For example, a vintner reports increases in the costs of many materials, including grapes, glass, corks, and labels, which have led to slight increases in his company's wine prices. Newsprint prices seem to be stabilizing after dramatic increases earlier in the year. Reports indicate recent price decreases for natural gas, plywood, and used cars.

Consumer Spending

Sales of soft goods have been relatively flat since late summer, although one respondent notes some improvement during October and early November. Weakening consumer spending also has been reflected in reduced spending on advertising in both print and broadcast media.

October was a sluggish month in the retail automobile business, with weak demand for new cars. Moreover, a general absence of buyers at wholesale used car auctions suggests that the used car market, which until recently had been very strong, may be weakening as well.

Manufacturing

Respondents generally indicate that manufacturing activity is strong, particularly in the Northwest. Increased aluminum production in the Pacific Northwest has cut the region's previous electricity surplus in half. Capacity constraints are clearly evident in the aerospace industry, as Boeing has a three and a half year backlog of unfilled orders

for commercial aircraft. A shortage exists for titanium dioxide, a key whitening and opacity agent used in paints and coatings. No additional production is anticipated until 1992, but demand continues to grow, particularly offshore. As a result, the price of titanium dioxide continues to escalate.

At the same time, the volume of orders continues to decline in the semiconductor industry. The book-to-bill ratio (orders received divided by orders shipped) has fallen in each of the past six months, and now stands at a two-year low of 0.96. Moreover, many producers are experiencing declining profits, and some layoffs and plant shutdowns have been reported.

Agriculture and Resource Related Industries

Demand for lumber and plywood has fallen in recent weeks, and prices are eroding slowly. In contrast, log and timber prices remain firm due to continued strong export demand.

Bottlenecks and capacity constraints are easing in the paper business. The operating rate for linerboard, which is used to make boxes, declined about 2 percent during 1988. Demand growth slowed to a 2 percent pace, while the capacity growth rate surged to 3.5 percent. This rate of capacity growth was much higher than estimates made in 1987 suggested it would be. Newsprint operating rates also are declining, with significant capacity growth.

There continues to be a great deal of activity in gold mining in Nevada, both in production and exploration. The decline in the price of gold has not been large enough to have a significant adverse effect on the industry.

Construction and Real Estate

Construction and real estate activity continues strong in Washington, Oregon, California, and Nevada. One respondent from central Oregon notes that some title companies in his area are working their employees overtime to process the large volume

of transactions. Increases in California residential property values have slowed substantially from the 15 to 20 percent rates seen earlier this year.

In Utah, Arizona, and Alaska, however, construction activity remains at low levels. An Arizona developer reports that for the first time in twelve to fifteen years, property values are starting to decline. The average resale price for a single-family home in Arizona has fallen by more than 3 percent during the past year.

Financial Sector

Banks and thrifts report continued competition for quality loans. Some report that, as a result, credit requirements are being relaxed in order to attract additional business. Despite the relatively small volume of loans being made, many financial institutions are experiencing improvements in net income over last year.