

SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS  
BY FEDERAL RESERVE DISTRICT

September 1990

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## SUMMARY\*

Economic activity is expanding more slowly or declining in most Federal Reserve districts, but several districts report continued, modest growth. Weakness is most apparent in the northeastern and mid-Atlantic districts. Although patterns of consumer spending vary widely among districts, rates of increase are generally slowing. The districts' assessments of manufacturing activity range from moderate expansion to absolute declines. On average, however, there seems to be little movement in orders or production. Signs of a construction downturn are widespread, but not universal. While drought persists in some agricultural areas, soil moisture conditions are good or at least improved in most reporting districts. So far, the recent increase in oil prices has not affected domestic oil and gas drilling. Several district reports of credit markets focus on soft loan demand and some district banks offer examples of tighter credit conditions.

Consumer Spending

Retail sales patterns vary widely among districts, but growth appears to be ebbing. While Minneapolis cites "good" sales increases, Atlanta and Boston note flat to modest expansion. New York and Philadelphia report absolute declines in dollar volumes from a year earlier. Sales of big ticket items are said to be particularly soft, but clothing sales continue to show strength in some districts. Several districts mention the negative impacts of higher

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oil prices. Despite demand weakness in some districts, most retailers say their inventories are at desired levels.

Auto sales are up in Minneapolis and Cleveland but are weak or slowing in Atlanta, St. Louis, Kansas City, and San Francisco. One district says that credit tightening has caused some potential auto buyers difficulty in finding financing.

### Manufacturing

Demand for manufactured products shows little overall change in either direction. Minneapolis and San Francisco characterize their manufacturing sectors' performances as mixed, while growth in Atlanta is moderate except for construction and auto-related products. Orders to Boston, Richmond and Philadelphia firms are down, and sales have not changed lately in the Dallas District.

Sales patterns differ greatly among industries. Atlanta, Chicago, Cleveland, Dallas, and San Francisco mention strength in demand for primary metals, while Boston and Dallas note weakness in orders for computer, and some construction-related products. Some districts report increased producer uncertainty about future demand.

In some cases, export demand appears to be stronger than domestic sales. Richmond notes exports of manufactures as among the few district manufacturing indicators that are not negative. Minneapolis says that strong foreign demand for producers' equipment has more than compensated for declines in domestic orders. In the Boston district, however, export sales are below a year earlier.

With respect to changing costs of operation, a number of districts cite rising freight costs in the wake of energy price hikes. Several districts,

including Philadelphia, Richmond, and Chicago report increasing prices of inputs, but Atlanta reports prices of industrial commodities as steady.

### Construction and Real Estate

References to declining construction activity and weakening real estate markets are common. Increases in homebuilding in the Dallas and Minneapolis markets are exceptions, but Minneapolis also notes marked declines in overall construction contract values in the Minneapolis-St. Paul area. While Kansas City mentions recent upturns in housing starts, homebuilding there remains below a year earlier. According to the San Francisco report, construction activity is slowing in many parts of the west. Moreover, Boston, Chicago, St. Louis and New York all refer to weakening residential construction or weak housing sales and Cleveland notes high office and retail vacancy rates. Several reports say that respondents expect continued construction weakness in the near future.

### Agriculture

Reports on agricultural production are generally positive, in part, because the soil moisture problems mentioned in the last beige book have ameliorated. In the Richmond District, rainfall in August was mostly above normal and soil moisture levels are now said to be adequate, but the dry weather in June has lowered corn yields. The Dallas District reports that rainfall has improved soil conditions there. Crop conditions are also good in the Chicago, Kansas City and Minneapolis districts. Inadequate soil moisture continues to impede crop development in portions of the St. Louis district. The St. Louis and Dallas districts discuss the negative effects upon rice prices of the embargo on sales to Iraq. St. Louis also notes that recent increases in freight and insurance costs have discouraged exports to other

Middle Eastern countries. Several district reports mention generally falling grain prices.

### Energy

Despite marked increases in oil prices in the wake of Iraq's invasion of Kuwait, reporting districts say they have seen few effects on drilling so far. Dallas and Kansas City note recent declines in drilling activity, although the rig count remains above a year earlier in both districts. Moreover, industry observers in both districts say they do not expect the recent price shock to have much of an effect until oil prices remain high for an extended period and natural gas prices rise as well.

### Finance and Credit

Most reporting districts say that lending activity is soft. Atlanta, Cleveland, and Philadelphia all mention recent slowdowns in lending, while New York notes signs of weaker demand for business loans. St. Louis cites slow loan growth at the large banks, but Kansas City district bankers report moderate increases in loan demand - including demand for commercial and industrial, consumer, and home mortgage loans. Financial organizations in several districts note tightening credit policies for at least some borrower groups. Banks' and thrifts' concerns over the viability of economic growth is said to have discouraged some lending.

## FIRST DISTRICT-BOSTON

Economic activity continues to slow in the First District.

Retailers and wholesalers generally report flat or marginally higher sales compared to a year ago, but some are recording substantial declines. Most manufacturers are finding 1990 tougher than expected. A majority of manufacturing contacts face sales below year-ago levels, and several are eating into their order backlogs. Three-fourths have cut employment levels, and half are paring their capital spending plans. Neither retailers nor manufacturers see reason to expect improvement during the next 6 to 12 months, although some retailers believe their promotional activities or cost controls provide a buffer against the poor economic climate.

**Retail**

For the most part, retailers and wholesalers report flat or marginally higher sales compared to a year ago. Only pharmaceutical sales are said to be rising at a double-digit rate. Some retailers are experiencing declines of up to 20 to 30 percent for building materials and higher-priced clothing. Respondents generally note that consumers are emphasizing essentials, trading down, and shopping around for bargains. Sales in the northern areas are holding up better than in the three southern states and the southern parts of New Hampshire and Maine.

Respondents report little increase in prices, and many durable goods prices are down from a year ago. About half the sample reported that gross margins are stable, and half declining.

In the context of much negative economic news, the majority of respondents expressed satisfaction with successful strategies in advertising and promotions, or in control of inventory and capital costs. No respondent expects an upturn soon. The majority think that demand will be flat for another year, but a significant minority expect further declines before the economy stabilizes.

### Manufacturing

According to First District manufacturers, this year is turning out to be "rougher than expected." A majority of these firms report that shipments are flat to down from year-ago levels, with declines ranging from 2 to 10 percent. The respondents with sales increases saw gains of 2 to 6 percent. Companies reporting slowing orders or dwindling backlogs outnumber those seeing improvement.

Products reported to be facing relatively strong demand include "recession proof" consumer necessities, plastics for the auto industry (where current production levels may reflect strike preparations) and equipment with long lead times, such as power-generating and medical systems. Demand is weak for paper goods and for products related to the computer, construction or defense industries. Even the export markets appear less robust. Only one firm reports strong export growth (albeit slower than in 1989); others mentioning exports say they are flat or down versus their 1989 performance. Accordingly, while a majority of contacts describe their inventory levels as satisfactory, a sizable minority find them excessive and are trying to bring them down.

In this environment, all respondents describe materials prices as stable or below 1989 levels so far. They mention declines in prices for metals and computer components in particular. By contrast, in the

aftermath of recent oil price increases, plastics prices are expected to rise by year-end. As for selling prices, while discounting prevails in the computer industry, one-half of all respondents have raised prices in 1990, generally by 3 to 5 percent.

Employment and capital spending plans are being cut. Three-fourths of the First District manufacturing respondents have reduced their employment levels - by 2 to 15 percent - during 1990. Over one-fourth expect additional layoffs before year-end. Most contacts had budgeted capital spending for 1990 to be equal to or less than 1989 levels. Half have now pared these spending plans or have made "judicious delays."

A minority of First District manufacturers contacted expect 1991 to be flat with 1990. The rest are less sanguine and, "seeing problems everywhere," are revising their forecasts downward. They cite the bite of decreased defense spending, deferred capital spending, declining consumer confidence, high debt levels, conservative banks, and, most recently, uncertainty about the Middle East and the price of oil.

#### Residential Real Estate

First District realtors agree that the real estate market is slow this summer. A general uneasiness about the regional economy is the most frequently cited cause. Realtors also feel that recent world events and uncertainty over the national economy have contributed to the slowdown. Prices are falling; sellers are listing their homes at more realistic levels in order to move them, and smaller homes (for first-time buyers) are selling better than larger homes. New construction has slowed considerably since this time last year. Realtors do not expect an upswing in home sales this fall unless the regional economy turns around.

## Second District--New York

Developments in the Second District economy continued mixed to somewhat soft during recent weeks. On the positive side, unemployment rates remained below the national average and the pace of office leasing was good in much of the region. Retailers reported disappointing sales results, however, and homebuilders reported no improvement in market conditions. Most respondents surveyed at small and medium-size banks described current economic conditions as soft or slow.

Consumer Spending

District retailers reported disappointing sales results since they were last contacted and a worsening of conditions as the period progressed. All our contacts reported year-over-year declines in August as consumers seemed increasingly reluctant to spend. This compares with over-the-year sales gains that were somewhat below plan but, in most cases, positive during July. Big ticket items such as furniture and rugs were especially hard-hit and other types of home furnishing were also weak. Sales of men's and women's apparel showed some improvement, though.

Over-the-year sales results in July ranged widely--from -6 percent to +14 percent--but in August results clustered in a -10 percent to -2 percent range. Despite the below-plan sales volume, however, inventories were reported at comfortable levels and, in some cases, below plan. One retailer did remark that if consumer spending continues weak, a cutback in the targeted level of inventories will probably take place.

Residential Construction and Real Estate

District homebuilders report no improvement in market conditions during recent weeks. In downstate New York and northern New Jersey residential construction activity continues to be very slow and respondents

do not anticipate an improvement in the foreseeable future. Housing starts have also declined in some upstate New York areas, but the over-the-year slowdown was from a previously high level of activity and has not been as severe as in other parts of the region. The shortage of credit for acquisition and construction loans continues to be a problem. In addition, some respondents noted that potential buyers are hesitant because of softness in the economy and uncertainty about the impact of the Middle East crisis.

The pace of office leasing remained good in much of the District during recent weeks as tenants continued to avail themselves of generous landlord concessions. Leasing in midtown Manhattan was the highest in several months and leasing in downtown Manhattan also expanded. However, with the addition of two newly completed buildings in mid-Manhattan, the midtown vacancy rate moved somewhat higher though the downtown rate held steady. Westchester County reports a reduction in the amount of leasing activity as very few large-scale transactions have recently taken place, and the absorption of vacant space in northern New Jersey has also slowed.

#### Other Business Activity

District unemployment rates remained below the national average in August. New York's rate declined to 5.0 percent from 5.3 percent in July while New Jersey's rate was unchanged at 4.8 percent. Employment conditions vary greatly within the District, however, with increased weakness in the New York metropolitan area coupled with strength in some other areas. A recent BLS study found that during the first five months of this year a loss of several thousand private sector jobs occurred in New York City and northeastern New Jersey--the first drop in local private employment since 1982. On the other hand, some areas in upstate New York and parts of New Jersey have reportedly been experiencing labor shortages.

The percentage of Buffalo purchasing managers reporting an increase in new orders rebounded in August after a sharp drop in July. The percentage with stable or greater production also rose. In the July survey of Rochester managers, however, only 25 percent of respondents anticipated improved conditions over the next three months, down from 47 percent in June. The outlook for capital investment in both areas was described as generally weak.

#### Financial Developments

Most respondents surveyed at small and medium-size banks in the District described current economic conditions as soft or slow. All of the banks that make business loans reported weaker demand, while demand for consumer and home equity loans has been mixed. Although several bankers stated that real estate loan demand had declined significantly, two bankers noted increased activity in August after a decline in July.

Just under half of the bankers surveyed said that they had begun to tighten credit standards on all types of loans. Over sixty percent of those making business loans had tightened standards on those loans. While none of the surveyed banks have raised interest rates as a means of tightening credit, about half have reduced the maximum lines of credit available to new borrowers and increased collateral requirements. One banker stated that his bank will scrutinize loan applications more carefully because of an anticipated recession. All of the bankers tightening credit gave a less favorable economic outlook as the main reason, and almost three quarters cited a deterioration in the quality of their loan portfolios as well. About half mentioned that they had faced more loan defaults and increasing regulatory pressures. Of the banks which had not tightened credit only one expected to do so in the near future. Most of the others will continue to lend both because they have an adequate supply of funds, and because qualified borrowers are still in the market.

## THIRD DISTRICT - PHILADELPHIA

Economic activity in the Third District appeared to be slowing across the board in August and early September. Manufacturers reported a continuing decline in business, leading them to trim employment. Retailers generally indicated that sales in August fell from the prior month and year, and they said that the slowdown was continuing in September. Bankers reported a decline in overall lending triggered by a falloff in business and real estate lending; consumer lending continued to increase, but the pace of growth was slackening.

Business contacts expect the downward trend in business to continue. For the most part, they do not have positive views regardless of the outcome of the Middle East crisis. Manufacturers forecast declining activity over the next six months, and they plan to trim capital spending and to make more cuts in employment. Retailers say consumer confidence is ebbing, and they expect consumer spending this fall to drop below the year-ago level, in real terms. Bankers anticipate continued declines in business and real estate lending, and they expect consumer loan growth to slacken further. In general, bankers expect business to decline well into next year.

MANUFACTURING

According to Third District manufacturers contacted in late August business was generally declining. Half of the firms queried reported a drop in activity, and almost half indicated that business was flat; very few were experiencing improvement. Among the major manufacturing industries in the district, slowing business was reported by producers of lumber, rubber and plastics, primary metals, nonelectrical machinery, and transportation equipment. Business was generally steady for makers of apparel, textiles, electrical machinery, and fabricated metal products. Improvement was common only among chemical companies

and producers of stone, clay, and glass products.

For the Third District manufacturing sector as a whole, shipments and orders were declining, prompting area firms to cut working hours and payrolls. In particular, makers of consumer goods reported that cutbacks in orders from retailers were becoming more widespread. Despite the drop in activity, inventories were edging down, overall.

The balance of opinion among Third District manufacturers contacted in late August is that business will continue to ease over the next two quarters. Overall, area firms plan to make further reductions in employment over the fall and winter months, and they plan to trim capital spending.

Despite their assessment that business is slowing, and will continue to do so, manufacturers reported spreading increases in input prices, and they expect further hikes. Most indicated that cost increases, current and anticipated, are for specialized inputs used directly in the production of the goods they make, and not necessarily for petroleum-based materials or for energy.

#### RETAIL

Third District retailers contacted in early September generally indicated that sales in August slowed from their early summer rate and that the dollar volume of sales for the month was below that of August of last year. Most also said that sales in the first week of September were below the year-ago period. According to merchants the slowdown has affected all categories of goods, including back-to-school merchandise.

Retailers said they believe consumer confidence is ebbing, and they expect the rest of the fall season to be slow. The consensus of forecasts is that sales through the rest of the year, in current dollars, will only equal the year-earlier period. Store officials did not express concern about current inventory levels, but they were being very cautious in their orders to suppliers, and they

said extensive price markdowns are a possibility later in the season if consumer spending declines much further.

#### FINANCE

Total loan volume outstanding at major Third District banks has declined since mid-July, and bankers contacted in early September said the downtrend was continuing. Commercial and industrial lending was edging down, according to bank loan officers, partly due to implementation of tighter credit standards but mainly because of a falloff in demand for business credit. Real estate loan volume was declining as payoffs reduced outstandings at area banks while they were booking virtually no new real estate-based loans except home equity credit lines. Bankers generally reported increases in personal lending, but they said the rate of growth appeared to be slipping. Auto loans were declining at most banks, while credit card lending was described as flat to up slightly by bankers.

Looking ahead, Third District bankers expect total loan volume to continue to fall. Several banks noted that requests for business financing, especially for capital investment, were tapering off. Most of the bankers contacted said they anticipate flat or declining economic activity through the rest of this year and into next, and they expect business lending to shrink over the same time period. They also expect real estate lending to continue to fade, and they anticipate slackening consumer loan demand.

## FOURTH DISTRICT - CLEVELAND

Summary. Fourth District respondents expect that the economic expansion will be sustained at least through the final quarter of 1991, despite short-run effects of the oil-price shock. The worst of the inflation bubble is expected to occur next quarter. The oil-price shock is expected to weaken consumer spending further, but District retailers generally report their August sales turned out to be better than expected. Manufacturers are cautious about short-term prospects for output, but generally acknowledge that effects of the oil-price shock so far have been relatively minimal. Lending activity by banks and thrifts appears to have slowed further in recent weeks.

The National Economy. District respondents generally expect that the expansion will be sustained at least through 1991, despite short-term dampening effects of the oil-price shock. A panel of 21 Fourth District economists expects that growth in real GNP will slow to about 1% between 1989:IVQ and 1990:IVQ, which is about one-half the increase they expected last May. Only a handful expect a two to three quarter contraction in real GNP, of 1% to 3% at annual rates, beginning either in 1990:IIIQ or 1990:IVQ, and extending into 1991:IQ. For 1991, the panel expects slow but steadily rising growth in output from the first quarter through the fourth quarter. The median forecast of real GNP shows growth of 1.9% for the year, somewhat less than they expected last May. There are no recession forecasts for 1991.

Inflation Outlook. The recent jump in crude oil prices is generally expected to have temporary effects on inflation. An inflation bubble is expected between 1990:IIIQ and 1991:IQ, with the worst of inflation expected to be at nearly a 5% annual rate next quarter. Thereafter, inflation is

expected to revert to a 4% rate through the balance of the 1991. While most of the panel of 21 forecasters expects a temporary burst in prices at slightly below a 5% rate, several expect that the GNP implicit-price deflator will rise between a 5% and 9.5% rate into early 1991 before moderating.

Consumer Spending. The oil-price shock has weakened the near-term outlook for real consumer spending, according to the Fourth District panel of forecasters. They now believe that real consumer spending between 1990:IIQ and 1990:IVQ will increase by about 1% instead of the 2% they expected last May. Nevertheless, sales reported by retailers and producers of consumer goods in August were generally as good as, or better than, sales in July.

Department store retailers in this District are less optimistic about sales prospects for the fall season. Most report, however, that sales in August rose from July, but that increases were smaller than in the previous month. Retailers generally expect that price promotions will be necessary to sustain sales over the next few months. Retailers in Cleveland report that their back-to-school sales in August were as good as, or better than, sales last year. Auto retailers report August sales were about as expected, and, in some cases, better than in July. Some report a step-up in consumer interest in fuel-efficient cars, and most dealers report buyers are still leaning toward more expensive rather than mid-priced cars.

According to some auto producers, car sales in August were better than they expected in their pre-oil-shock forecasts. Some believe that the timing of the consumer confidence surveys may have biased the survey results, and expect future surveys to show some recovery in consumer confidence.

Manufacturing. District respondents in manufacturing and utilities are typically cautious about short-term prospects for production and profits

because of uncertainties over the oil situation. They report no unusual deferments or cancellations of orders or spending in response to the oil-price shock. They emphasize a lessened dependence on oil, a more efficient capital stock that has been installed in anticipation of even higher real prices for oil than at present, and the relatively small price increase in crude oil now compared with episodes in the 1970s.

The steel industry is still operating at close to effective capacity, and producers report a strong third quarter for orders and production. A producer reports that orders for October are being booked at a good pace. There is a tone of less confidence over the short-term outlook because of uncertainty about the effects of the oil situation on the auto and appliance industries. Steel producers point out that their industry is more energy efficient now than even five years ago. Crude-oil costs are a relatively small part of production costs, but the added fuel cost will hurt already squeezed profit margins because additional costs cannot be passed through to steel consumers.

Some capital-goods producers are less optimistic about short-term output and spending plans, because they expect that the uncertainty over the oil situation will temporarily erode business confidence. Some expect that there could be a temporary deferring, or postponing, of short-lead-time equipment from this year into early next year. They also emphasize that capital stock additions in recent years anticipated real oil prices even higher than at present prices.

Auto production next quarter will likely exceed new car sales, barring work stoppages, but dealers' caution about holding inventories and deterioration in consumer confidence are likely to be constraints on auto output plans. Light truck output will be hampered by a 100-day inventory.

Heavy-duty truck output is reviving slowly from a trough in late 1989 and early 1990, and output this quarter will likely be the best so far this year.

A major electric power utility in Ohio believes that the effect of the oil-price shock is minimal because their facilities have become marginal users of crude oil. Also, more efficient energy use by the utility's industrial accounts have sharply reduced the effects of oil price increases.

Financial Developments. Some banks and thrifts report a further slowing in lending activity in recent weeks. Mortgage interest rate increases of at least one-half point on fixed-rate mortgages since early August have dulled mortgage lending. Some lenders also state that concerns about rising delinquencies and increasing nonperforming loans that are reported nationally are contributing to more cautious lending policies. While some expect near-term cutbacks in consumer spending, they also believe that consumers will not curtail spending as much as most forecasters expect.

High office and retail vacancy rates in many metropolitan centers, coupled with tightened lending terms, have moved some developers to shift their operations into other kinds of construction. A large shopping mall developer, for example, will increasingly focus on construction of residential communities. Another developer has been moving into apartment construction from office building.

## FIFTH DISTRICT-RICHMOND

Overview

District economic activity slowed somewhat in recent weeks. Retail stores, tourist areas, and manufacturing plants reported that business conditions softened. Higher oil prices raised manufacturers' costs and pushed up prices for finished goods. At financial institutions, the demand for consumer loans fell slightly. In most District areas that are highly sensitive to defense spending, business continued to slow. In some local economies heavily dependent on military personnel, the Mideast deployment crimped consumer demand. On a positive note, exports rose more than imports at District ports, and prospects for District farmers are generally good.

Consumer Spending

Retail activity apparently softened in August while profit margins shrank. Responses to our regular mail survey of retailers indicated that sales, especially of big ticket items, declined from July to August. Retail employment was also down from our previous survey. Two-thirds of our survey respondents reported increases in the prices they paid, while only one-third noted increases in the prices they charged.

District tourism was lackluster in the last month of the summer season. Our telephone survey of hotels, motels, and resorts indicated a slower August and Labor Day weekend than a year ago. Respondents who experienced declines blamed a generally weaker economy. Only one resort manager thought that higher gasoline prices kept tourists away. Most of those surveyed reported that fall bookings were about even with last year's. Respondents

remained optimistic about tourist activity in coming months, but they were less so than in our previous survey.

### Manufacturing

Our regular mail survey showed that manufacturing activity slowed from a month earlier. All survey indicators except prices and new export orders declined. Almost half of the producers identified poor sales as the most important problem they faced.

Virtually all manufacturers were adversely affected by higher crude oil prices. Raw materials prices and transportation costs rose for all but a few respondents. To adjust to these increased expenses, half said they had raised or would raise their prices, a third said they would try to decrease other nonemployment costs, and one-tenth planned to cut employment.

Manufacturers' assessments of current conditions and their forecasts were more pessimistic in August than in July. A larger majority believed that their local economies and the national economy weakened in the latest month, and only one-fifth now expect business conditions to improve in the next six months.

### Ports

District port activity continued to shift toward exports, which rose in August from July and from a year ago. Imports were down from July but were generally unchanged from a year ago. All three major District ports-- Baltimore, Charleston, and Hampton Roads (Norfolk)--expect exports to increase faster than imports in coming months.

The volume of coal exports has apparently not yet been affected by developments in the Middle East. Some of the largest coal shippers, however, expect to export more if crude oil prices remain high.

### Financial

A telephone survey of District financial institutions suggested that the demand for consumer loans fell slightly in August from July. More lenders reported decreases than increases in new consumer loans. Respondents indicated that declines in installment credit more than offset increases in revolving credit. Additionally, nearly all lenders reported no change in the rates charged on consumer loans in August.

### Agriculture

As of the second week of September, the fall harvest was on schedule and most crop yields were expected to be about average around the District. Corn yields, however, will probably be below average in Virginia and in the Carolinas, due to June's hot, dry weather during the corn crop's crucial pollination period. Rainfall in August was above normal across most of the District, and soil moisture levels were reported to be generally adequate.

### Defense Impacts

Business leaders in the Washington and Norfolk areas indicated that the adverse economic effects of defense budget cuts intensified this summer. They said that cutbacks in current and projected defense spending lowered the use of contract personnel and support services such as advertising, printing, and travel; they blamed these effects, in part, for continued declines in real estate values and construction activity.

The Mideast military deployment slowed business in parts of Virginia and the Carolinas. In areas where large numbers of military and support personnel had been stationed and were sent overseas, local business leaders said that retail sales were off sharply; automobiles, appliances, and fast food were

particularly hard hit. Contacts in the Washington area noted that the Mideast crisis diverted defense funds away from local contractors that primarily provide long-term, research-oriented services, and toward items of immediate use in the field. The call-up of reserves and the departure of troops, many of whom held second jobs, depleted the supply of workers in some areas where labor markets were already tight. The Mideast deployment, however, evidently gave a boost to some District manufacturers. A textile producer, for example, recently received a large government order for tent fabric.

## SIXTH DISTRICT - ATLANTA

Overview: Business contacts throughout the Southeast indicate some further deceleration from the slow pace of growth reported in recent months. Uncertainties associated with the Mid East crisis and higher oil prices are reportedly adding to consumer caution. Retailers report that they are generally reducing orders for new inventory in light of anticipated consumer resistance and their expectations that sales growth will remain sluggish through the fourth quarter. Auto dealers confirm that sales remain soft and note particular weakness in the markets for high priced autos and used cars. District bankers indicate that growth in consumer and real estate lending was weak while commercial lending declined this past summer. Southeast manufacturers, however, still report generally moderate growth except for products related to the construction and auto industries. Shortages of skilled workers continue in a number of areas.

Retail: Reports from southeastern retailers indicate flat to modest sales growth during July and August relative to the same period in 1989. Expenditures on both durable and nondurable goods varied considerably around the District but generally durables were weak while apparel sales showed a bit of strength associated with back-to-school clothes purchases and summer clearances. A representative of a large retail chain indicated that furniture and fine jewelry sales were off significantly from 1989 levels in July and early August, for the first time this year. The general sentiment among southeastern retailers is that already weak consumer confidence has been negatively impacted by the Mid East crisis and oil price advances during the last six weeks. As a result, these retailers are reducing the size of their orders to manufacturers expecting that growth in sales will remain sluggish through the fourth quarter.

Auto dealers continue to report that sales were well below levels seen a year ago, especially during the first two weeks of August. Foreign models again sold better than domestic ones. A few dealers indicated consumers are more resistant to the higher priced models and said

that sales of new autos priced under \$15,000 were comparatively better. Some noted that it was too soon to detect any switch toward more fuel-efficient models.

Financial Services: Bankers in the District generally report that slow growth in real estate and consumer loans over the summer was not sufficient to offset declines in commercial lending. The weakness in commercial lending is said to be related to some deferred capital expansion plans and lean business inventories. A few bank contacts indicated they had further tightened credit standards in the last month. A number of others said they had not tightened standards but were adhering more closely to existing criteria. Most bankers, however, agreed that money is available for good projects and that reports of tighter credit seem exaggerated.

Growth of consumer loans in July and August was reportedly "anemic." Bankers indicate that demand for auto loans continues to weaken, but they continue to indicate a moderate expansion in home equity lending and single family mortgages.

Manufacturing: Manufacturers in the Southeast indicate moderate growth in sales except for construction and auto-related products. Paper mills are reported to be running at capacity levels, partially due to export activities and coal production is picking up. Pipe manufacturers report demand by the domestic oil and gas industry is strong. Chemical and plastic producers also noted a continuation of a recent slowdown from strong growth.

Weak new and existing home sales continue to impact the southeastern textile industry. Carpet producers indicate demand continues to be soft and that downward price pressures are evident at the wholesale level. They do not anticipate any improvement for some time. New layoffs by southeastern tire producers were reported and an auto assembly plant was closed for a week due to poor orders. Apparel producers note continuing weakness, adding that competition from imports is intense.

Wages and Prices: Scattered reports that skilled workers are in short supply continue to come in from around the region, especially from the oil and gas producing areas. But these shortages have not resulted in any new upward wage pressures. A union contact indicates that wages among his constituents rose 3.8 percent during the last 6 months compared to 3.5 percent for the previous 6 months. Prices of industrial commodities were steady, with the exception of sharp increases in the energy sector. Freight costs are reportedly up 1.5 percent since early August due to the recent fuel price increases. Most industries report that the higher energy costs are not yet being passed on to consumers.

## SEVENTH DISTRICT--CHICAGO

Summary. Economic conditions in the Midwest were somewhat uneven in August, but most of the District's economy continued on the slow growth path reported in recent months. Consumer spending in the District generally showed modest growth, except in Michigan. Purchasing manager surveys around the District gave mixed signals, but anecdotal evidence indicated slow expansion in the manufacturing sector. Construction and real estate activity slowed, but remained healthier in the Midwest than in the nation as a whole. While most large banks have not changed lending standards, some District loan officers reported a slight tightening, citing a less favorable economic outlook. District reports indicated no acceleration in the overall inflation rate since the recent rise in the price of oil. Crop conditions continued to be favorable.

Consumer Spending. Consumer spending growth in the District has been modest but stable in recent weeks, although local surveys conducted after the Middle East crisis showed sharp declines in consumer confidence. A spokesman for a department store chain reported "below-plan" national sales growth in recent months, but noted that growth in the Midwest remained intact during the summer. A representative of a discount chain stated that sales of back-to-school items were "very good," but overall sales in the Midwest were weak relative to other regions, in part due to unseasonably cool weather limiting sales of fans and air conditioners. An analyst for a general merchandise chain reported that August sales, after being down in the first week of the month, increased over the year-earlier period. District sales were mixed for this chain, however, with strength in some Midwestern markets partially offset by significant weakness in those areas of Michigan and Indiana linked to the auto industry. Results of several independent surveys in August, however, showed sharp declines in consumer confidence around the District.

Auto sales nationally were little changed in August from recent months, with sources indicating that the Middle East situation has not yet influenced sales. One Midwest dealers' association executive noted that orders for larger cars have not yet been cancelled. A District

import car distributor experienced record July sales and reported that August sales were on track to be the best single month in the history of the distributorship. However, a domestic automaker estimated car sales in the remainder of 1990 could drop roughly 500,000 units (saar) below previous estimates, if oil prices stabilize in the neighborhood of \$25 per barrel.

Manufacturing. Manufacturing activity in the District generally continued to expand at a slow pace in recent weeks, although some soft spots exist. An auto economist reported production in the summer months to be slightly above normal, due to model changeovers taking place earlier in the year than normal. Downward revisions in production schedules over the remainder of the year will be resisted, in the hope of addressing union concerns about job security. A supplier of truck engines reported that sales softened in late July and early August, however, and truck producers recently lowered their 1990 sales estimates, citing the absence of a previously anticipated increase in demand for trucks produced prior to the introduction of new fuel efficiency standards for 1991 models. A steel economist reported full order books for the third quarter, and stated that fourth quarter bookings were doing "quite well." A major capital goods producer reported little change in July shipment growth from the steady growth experienced in earlier months, and new orders continued their slow upward trend. A producer of electronic and computer components, however, reported lower domestic sales growth than expected, which was attributed primarily to a slowdown in the development of new technology rather than to a fundamental shift in demand.

Purchasing manager surveys in the District showed mixed results for August, continuing an uneven pattern. On a seasonally adjusted basis, the Chicago index showed conditions improving slightly in August, led by production, new orders, and prices. The Milwaukee report was mixed, but indicated new strength in the new orders component. The Detroit index in August showed its sharpest drop since November 1987, with both the automotive and non-automotive sector indexes showing contraction. On balance, however, recent District activity has been relatively stronger than that reported in the national survey.

Construction and Real Estate. District construction and real estate activity slowed somewhat in recent weeks, but continue to fare well relative to the national trend. A supplier of gypsum board reported that Midwest residential and non-residential contract awards (in floor area) posted solid gains year-to-date (through July) in 1990, while awards declined nationally. A cement producer reported that industry shipments in the Great Lakes region grew on a year-over-year basis in the first half of the year, and that the firm's Chicago-area backlog in early August increased significantly from both a month earlier and a year earlier. However, a District service firm involved in the early construction process reported recent new building activity in several major metropolitan areas of the District has "slowed to a trickle."

Area housing sales grew in July, compared to a national decline. The Midwestern market remains one of the "healthiest in the nation," according to a District realtor. However, this contact reported softening overall housing sales in recent weeks, citing a recent rise in mortgage rates, increased uncertainty generated by the Middle Eastern crisis, and a slowdown in company transfers. The Detroit market was reported to be running below last year's pace in the first half of the year, and slowed further recently.

Financial Markets. While lending standards at several large District commercial banks have changed little in recent weeks, their loan officers cited some tightening in selected sectors. Several loan officers told of tighter standards for middle market commercial and industrial customers, while one reported stricter standards for both large and small firms. Stricter standards were generally attributed to a less favorable economic outlook, but one contact cited stress on the bank's capital position. Tightening occurred most often in the form of stricter covenants and collateral requirements. To the extent that tightening has occurred, standards for construction, land development, and other commercial real estate loans have been tightened somewhat more than for commercial and industrial loans.

Prices. Despite the recent rise in the price of oil, several District contacts reported downward pressures on the prices of a variety of goods. An analyst with a major retail chain reported that pre-Christmas type discounting by competitors is already beginning to occur.

Although housing prices are holding up relatively well in the Midwest, the rate of increase has slowed substantially in recent months. On the manufacturing side, the price component of the Chicago purchasing manager survey indicated more respondents paying increased prices in August than in July, although the trend was basically unchanged from that in June and July. One District manufacturer of heavy moving equipment reported prices declining in the face of weaker demand. Crop prices have fallen in recent weeks.

Agriculture. Midwest crop conditions appear favorable. A high proportion of the corn and soybean acreage is rated good-to-excellent in District states. Recent warm temperatures are believed to have added somewhat to the harvest potential and eased concerns about an early frost on this year's late maturing crops. Crop prices, especially for corn, have retreated considerably in recent weeks as export prospects have deteriorated and the forthcoming harvest promises adequate (but still relatively tight) supplies for the year ahead. The declining corn export prospects reflect a large world wheat harvest this year and the likelihood that wheat will displace some corn in livestock feeding rations.

## EIGHTH DISTRICT - ST. LOUIS

Summary

District contacts indicate that the economy has weakened slightly in recent weeks, implying that the District's growth rate borders on zero. Higher oil prices and consumer uncertainty stemming from the Persian Gulf crisis are expected to exacerbate the economic slowdown. The level of District employment has fallen this summer. Retail sales are reported as flat to up moderately and several contacts have an optimistic outlook for the rest of the year. Manufacturing activity has weakened in recent months, as have the construction and real estate industries. Despite moderate deposit growth, loan growth is flat at the District's largest banks. Most District crops are in fair-to-good condition, although some are being stressed by extreme heat and inadequate soil moisture.

Consumer Spending

Reports on recent District retail sales are mixed. Most contacts, however, report sales as flat to up moderately from a year ago. Many retailers report that recent sales met or exceeded their expectations and were obtained without excessive price-cutting. Inventories are generally at desired levels. Several contacts have an optimistic outlook for the rest of the year, but some are concerned about the potential negative effects of higher oil prices. Most retailers expect retail prices to remain stable through the end of the year, although a few think prices will rise this fall, in part because of higher oil prices. It is feared that the deployment of soldiers from a base in Kentucky will result in a

sharp decline in business activity in nearby communities. Contacts indicate that sales of new autos are generally weak while sales of used cars are strong.

#### Manufacturing

District manufacturing activity has weakened since the first quarter. Producers of home appliances, chemicals and electrical equipment expect flat or weakening demand in the next few months, as much of their demand is related to activity in the motor vehicle and construction industries, sectors that have been weak and are not expected to grow soon. One home appliance producer plans to lay off more than a thousand production workers in September, partly because of planned seasonal cutbacks, partly in response to a recent weakening of demand that is expected to persist. A car manufacturer recently announced that it will postpone the closing of a Missouri assembly plant until May 1991, delaying the expected November layoff of approximately 2,000 workers.

The conflict in the Persian Gulf has caused two manufacturers to be more cautious in extending credit to customers in the Middle East; one is holding up shipments of capital goods until previous bills are paid. No substantial price increases in chemical products due to higher oil prices are expected.

#### Construction and Real Estate

Residential real estate contacts in Little Rock, Memphis and St. Louis report weakness in new and existing home sales. These contacts believe residential real estate conditions will worsen in the next few months and anticipate no increase in construction over the next 12 months. Residential construction unemployment is high relative to historical levels in St. Louis and Little Rock and is expected to increase in the

next several months. Contacts in Louisville, however, report that residential real estate conditions are better than they had anticipated.

#### Banking and Credit

Despite moderate deposit growth, loan growth continues to be very slow at the District's 11 largest banks. Although real estate and consumer lending are up substantially from year-ago levels, overall loan growth remains weak because of a marked decline in commercial and industrial loans at Louisville and Memphis banks. Sluggishness in the residential housing market appears to be more demand-driven than supply-driven, as mortgage financing is plentiful.

#### Agriculture and Natural Resources

Most District crops are in fair-to-good condition. In some areas, however, a lack of adequate soil moisture and extreme heat are hampering crop development, especially soybeans and pastures. District coal production is running about 7 percent above last year because of strong exports, stockpile rebuilding and increased U.S. electric output. Recent oil price increases are not expected to have a significant effect on the demand for coal or coal prices. Contacts report that exports of rice and Southern pine lumber will be lower than previously expected because of the embargo of exports to Iraq and recent increases in freight and insurance costs for shipments to other Middle Eastern countries. Nonetheless, Southern pine lumber mills report that orders, production and shipments are all up compared to a year ago.

## NINTH DISTRICT--MINNEAPOLIS

Ninth District economic conditions have been moderately good lately. While labor market and manufacturing conditions have been mixed and construction activity has been weak, tourist spending has been strong, and new-car sales and retail sales in general have been fairly good. Resource-related industries have been doing well. In general, wage and price increases have been moderate. The Gulf crisis has not yet affected the district's economy much.

Employment, Wages, and Prices

Labor market conditions have been mixed in the district. After showing signs of improvement during the second quarter of the year, Minnesota's unemployment rates have begun to drift up. The state's overall unemployment rate was 4.6 percent in July, up from 4.2 percent in June and 4.1 percent in July 1989. In the district's other states, unemployment rates in June and July were roughly at the same level as last year. At the same time, firms throughout the district continue to report difficulties in filling entry-level and part-time positions, even at wages well above the minimum wage.

Wage and price increases in the district have remained moderate. Wages have generally increased only at annual rates of 3 to 5 percent. The Gulf crisis has not resulted in a sharp acceleration in the district's inflation rate--though, as is to be expected, gasoline prices have risen sharply. Some prices charged by freight companies have also increased. Prices of agricultural products have recently been declining, though they are still well above the levels of a year ago.

### Consumer Spending

District retailers of general merchandise report good sales growth lately. One major retailer reports that, compared to a year earlier, sales in August were up 8 percent and sales in the first eight months of the year were up 6.1 percent. An appliance retailer reports that sales in August were 3 percent higher this year than last. In North Dakota and Montana, retailers report that shoppers from Canada have contributed to strong sales. In North Dakota, sales tax collections have risen sharply from a year ago. Throughout the district, inventories are reported to be at acceptable levels.

Tourism remains the brightest spot in the district's economy. Motorcycle enthusiasts recently held their 50th annual gathering in the Black Hills of South Dakota. This rally reportedly brought an estimated \$30 million into the local economy. Also, resort owners in the Upper Peninsula of Michigan, Wisconsin's Arrowhead region, and northern Minnesota report fairly high levels of reservations for the fall colors viewing season. However, district resort owners generally are apprehensive that the recent rise in gasoline prices may crimp tourist activity.

New-car sales have been fairly good recently. One major dealer reports that sales at the end of August were strong. Dealers are cautiously optimistic about prospects for the second half of the year. Inventories of cars and trucks are reportedly at comfortable levels.

The district's housing activity has improved recently, after having shown signs of softening earlier in the year. The number of new housing permits issued in Minnesota, for example, was 6 percent higher this July than last. The number of houses sold in the Minneapolis-St. Paul area during the first eight months of the year was 6.6 percent higher than a year ago.

### Construction and Manufacturing

Conditions in the district's construction industry in general have been weak recently, particularly in the Minneapolis-St. Paul metropolitan area. In that area, the dollar value of contracts for future construction in June was 27 percent below the value a year ago. This area's weakness is expected to continue for at least a couple of years.

Conditions in the district's manufacturing industries have been mixed lately. Domestic orders for producer equipment have been lower than last year, but strong foreign demand has more than made up for that. The medical technology industry has grown strongly, but the electronics industry has continued to struggle. Manufacturing firms, in general, express serious concern about the increased probability of a recession.

### Resource-Related Industries

The district's resource-related industries appear to be fairly healthy. Excellent rainfall throughout the district has improved the outlook for farmers. The spring wheat harvest in Minnesota is expected to be the best in three years. In that state, the corn harvest is expected to be 5 percent higher than last year, but the soybean harvest is expected to be 10 percent lower, due primarily to fewer acres being planted. Farmers in North Dakota have had the best wheat crop on record. The mining industry is also doing well. However, the lumber and paper products industry, which has been growing strongly for the last two years, reports recent setbacks. Prices of products used in home construction have declined sharply. And according to several firms, finished paper inventories have been rising.

## TENTH DISTRICT - KANSAS CITY

Overview. The Tenth District economy is growing slowly. Retail sales have weakened over the last three months, with auto sales slumping as some potential buyers are finding it difficult to obtain financing. But rural business conditions generally continue to reflect the improvement in the farm economy over the past three years, an improvement that is expected to continue as bumper crops are harvested this fall. Retailers are trimming inventories, while manufacturers are trying to maintain or reduce their stocks. In the energy sector, drilling activity has slipped in recent months but remains above the level of a year ago. Housing starts are up from last month despite a slight increase in mortgage rates.

Retail Sales. Most district retailers have been trimming inventories in light of weakening sales over the past three months, especially in July. Expectations are mixed for sales over the next three months, while prices are expected to change little. New auto sales have dropped in most district states over the last month and are expected to drop further during the rest of the year. Some potential buyers are having financing problems due to credit tightening. Most dealers are trimming inventory levels to make room for new models.

Manufacturing. Purchasing agents report higher input prices from a year ago but generally stable prices over the last three months. Some prices have risen recently due to the Gulf crisis as fuel price increases have pushed up transportation costs. Agents generally expect more increases in input prices in the next three months. Agents are having little difficulty in obtaining inputs and most expect few problems for the rest of the year. Most firms are maintaining or reducing inventories.

Energy. Despite significantly higher oil prices since Iraq invaded Kuwait, exploration and development activity in the district has declined recently. The district rig count fell from 303 in July to 282 in August. Nonetheless, the rig count remains about 9 percent above the year-ago level. Industry observers do not anticipate much improvement in drilling activity unless oil prices remain above \$25 a barrel for an extended period and natural gas prices are eventually pulled up by higher oil prices.

Housing Activity and Finance. Housing starts in most areas of the district are up from last month, though still below levels a year ago. Sales of new homes remain mixed. Several builders report increases in lumber costs and a shortage of labor. The outlook for new home sales is mixed but biased toward a slowdown for the remainder of the year.

Most district savings and loan respondents report net outflows of deposits over both the last month and the last year. Mortgage demand is constant to down slightly and is expected to decline over the next three months due to seasonal factors. Mortgage rates have risen slightly at most institutions but are expected to decline slightly in the near future.

Banking. Commercial bankers report that total loan demand rose moderately over the last month. Demand increased for commercial and industrial loans, consumer loans, and home mortgages, while demand for commercial real estate loans and agricultural loans decreased. Loan-to-deposit ratios did not change over the last month but are down slightly from a year ago. Total deposits increased moderately over the last month, with increases in demand deposits, NOW accounts, MMDAs, and small time and savings deposits. Large certificates of deposit, IRAs, and Keogh accounts were unchanged. Bankers report no major changes in their prime rates or consumer

lending rates, and few expect any changes in the near future. About half of the respondents report that other loan terms--for example, collateral requirements and loan covenants--have recently been tightened or are being reviewed for possible future tightening. Although a few rural bankers report that credit standards have been tightened due to regulatory pressures or concerns about an economic slowdown, most indicate that credit standards for small businesses have not changed.

Agriculture. District crops are generally in excellent condition. Bumper crops of corn, soybeans, and milo are expected in Kansas, where a record wheat crop was harvested earlier this year. The Oklahoma cotton and peanut crops could be the best in years. Development of late-planted crops in eastern Kansas, Missouri, and Nebraska, however, is one to three weeks behind normal, making crops in those areas vulnerable to substantial yield reductions if an early frost occurs.

Higher fuel prices have not yet affected district farming activities, although harvesting costs will be pushed up. Prices of some fertilizers, pesticides, and other petroleum-based products may also rise if petroleum prices remain high. If this happens, farmers will reduce their use of these products next spring.

Business conditions in rural communities across the district generally reflect the rebound in the farm economy over the past three years. Still, the improvement in the district's Main Street businesses has not been uniform. Small businesses continue to struggle in some rural communities, while both established and new businesses thrive in others.

## ELEVENTH DISTRICT--DALLAS

The District economy continues to grow slowly. Orders for manufactured goods have shown little overall change. Retail sales have recently slowed. Auto sales slowed in early August but have since improved. Economic activity has increased in the service sector. The construction sector continues a mild improvement. Higher oil prices are stimulating increased production from existing wells but have not yet motivated new drilling. Recent rains have improved conditions for District farmers and ranchers.

Overall, manufacturing production and orders have not changed significantly during the past month, although orders for construction-related products have declined. Manufacturing inventories generally are at desired levels. Most respondents are concerned about the outlook for the U.S. economy now that oil prices have risen. Also, many industries are concerned about higher transportation costs due to the jump in oil prices. One food wholesaler is already planning to curtail costs by reducing deliveries from five to four per week. Recent oil price increases have had only a small effect on the demand for oil field machinery but respondents expect strong gains next year if oil prices remain high. Chemical producers say that product demand remains strong and they are switching feedstocks to reduce the impact of rising oil prices. Orders and production continue strong in the petroleum refining industry and producers are increasing product prices in line with crude costs. Refiners say that they have not experienced any shortages of oil. Steel production continues at high rates due to declines in imports, and producers continue to be optimistic about demand in the near future. Primary metal producers in the District generally say that oil is not

a significant energy source in their production process. Respondents in the apparel industry note a mild increase in sales and are cautiously optimistic about the next few months. For electronics producers, orders generally remain weak but several noted that sales to the telecommunications industry are strong. Demand for fabricated metals remains soft. Among stone, clay, and glass producers, a glass producer says sales have decreased significantly and a producer of concrete pipe notes a gradual slowing. Lumber and wood products producers say that demand from home builders has declined but one producer noted an increase in demand from lumber yards.

District retail sales have slowed significantly over the last few weeks. Respondents feel that uncertainty about problems in the Middle East has caused consumers to hold back purchases. Weakness is widespread across most product lines but respondents note a particular softness in durable goods. Discount stores continue to experience slightly stronger sales than other retailers.

District auto sales increased moderately in July. Sales growth was strong in the Houston area and mild in the Dallas/Ft. Worth area. Sales flattened in the first two weeks of August but picked up slightly during the second half of the month. Respondents note no increase in the relative demand for fuel-efficient vehicles.

Activity in the District service sector has increased. Temporary employment agencies say that demand is increasing strongly. A respondent in San Antonio said much of the demand is from firms which are reluctant to hire full time workers because the economy is slow. An accounting firm says that activity has picked up due to demand from the Resolution Trust Corporation. Consulting firms note continued increases in the demand for office automation

and management services. An increase in economic activity in Austin and Houston has created a slight increase in demand for legal services.

District construction activity continues to grow slowly. Most of the recent growth stems from increased residential construction in Texas. Single and multifamily building permits have increased. District nonresidential and nonbuilding construction remain weak. Nonresidential contract values are up but remain below levels reached last year. Respondents do not expect an upturn in commercial and industrial construction for at least another year. Nonbuilding contract values have fallen and respondents note that expenditures on state highways should continue to decrease in Texas but increase in Louisiana.

Recent gains in the oil price have not stimulated new drilling. The District drilling rig count declined in July and August. Respondents in the energy industry say that they are uncertain about what price will be sustained. Production from existing wells should increase, though, as increased revenues are used to upgrade old wells and reopen dormant wells. Most of the work will be done on stripper wells which produce less than ten barrels of oil per day. Some enhanced recovery procedures have also become profitable. Production should increase about 1.1 percent due to the lifting of production ceilings by the Texas Railroad Commission. One respondent noted that about half of the current drilling is for natural gas which has not yet increased in price.

Recent rainfall has improved conditions for District farmers and ranchers, although some dryland cotton and corn crops were already destroyed. Ranges and pastures have improved significantly in many areas. August prices

received by Texas farmers and ranchers increased 7 percent from last year and 2 percent from July. Rice prices continue to drop and are now 9 percent below a year earlier. Rice prices are expected to remain depressed until mills find alternatives to their Iraqi customers.

## TWELFTH DISTRICT -- SAN FRANCISCO

Summary

Economic activity in the West is growing at a modest pace, following some slowing in recent months. Since the Iraqi invasion of Kuwait, western business leaders' expectations of future national economic growth have weakened sharply. Price inflation remains around 5 percent, with the exception of the recent large increase in oil prices. Retail activity appears to be softening in most parts of the District. Manufacturing conditions are mixed, with strength in commercial aircraft and aluminum offset by weakness in some other sectors. The situation in the Middle East has shaken up energy-related industries, while agricultural conditions remain generally strong. Real estate and construction activity continue to cool off in the District's coastal areas, while most inland areas remain strong. Financial institutions note recent weakening in lending activity.

Business Sentiment

Western business leaders' expectations of future economic activity have deteriorated significantly since Iraq's invasion of Kuwait. 39 percent now expect a national recession during the next 12 months, compared with only 4 percent six weeks ago, and only 5 percent of respondents now anticipate that growth will be as strong as 2 1/2 percent, compared with 30 percent last time. Most respondents indicate that the Iraqi invasion has not yet caused changes in their business plans, beyond a renewed interest in energy conservation. One firm, however, has put new Middle East business on hold while a few others are approaching future capital investments with increasing caution.

Wages and Prices

Price inflation remains around 5 percent, with the exception of the recent large increase

in oil prices. Gasoline prices are up sharply throughout the District. Jet airplane fuel prices in Seattle are up 62 percent since the end of July.

Most respondents indicate that wages have risen by about 3 to 5 percent from their year-earlier levels. However, the cost of benefits continues to rise at a faster pace, with rising health care costs cited as the major factor.

### Retail Trade

Retail activity appears to be softening in most parts of the District. Auto sales have slowed and auto manufacturers continue to fatten rebates to prevent sales from eroding further. Sales of other durable goods, like farm machinery and home furnishings, also are reported to have weakened. Sales of nondurable goods are reported to be softening. A retailer in Southern California indicates that, excluding the effects of promotions, sales fell 5 to 6 percent in August from a year ago. Another West Coast retailer reports that, since July, sales have been up just 3 percent from a year ago, well off the 10 percent growth seen in earlier months. However, reports indicate that sales gains were considerably more robust in California's Central Valley, Alaska, Hawaii, and Utah.

### Manufacturing

Manufacturing activity in the District is reported to be mixed overall. Aluminum manufacturers continue to run at about 90 percent of capacity, and one observer suggests that an increase in demand for aluminum products may occur as the Defense Department builds up its inventory of spare parts. Newsprint manufacturers continue to do well, but the packaging and paperboard side of the industry has slowed significantly since last year. Orders for commercial aircraft have been relatively stable for the past three months, and most manufacturers continue to face multi-year backlogs. A paint and coatings manufacturer reports that some of his markets are starting to show signs of slowing, which represents a deterioration from last year when all markets

were accelerating.

#### Agriculture and Resource-Related Industries

Conditions in agriculture remain good overall. Agricultural prices continue strong for most crops except wheat and some feed grains, and livestock markets have held up better than expected. California's almond crop will be the largest ever, but the resulting downward price pressure may put prices below production costs. In the lumber industry, weaker sales are depressing prices and increasing inventories.

Interest in new oil drilling activity has increased in some areas of the District since the Iraqi invasion of Kuwait. One natural gas firm plans to increase capital expenditures by 65 percent this year over last year's level.

#### Construction and Real Estate

Real estate activity continues to cool in the District's coastal areas, but conditions inland remain strong. Home price appreciation in the Seattle area is slowing and the inventory of unsold homes is growing. Commercial leasing activity in southern California continues at a good pace, but net effective rents have declined 4 to 6 percent from last year as a result of persistently high vacancy rates. Home prices in Bakersfield and Sacramento continue to rise, but reports suggest that price increases may be slowing from their earlier phenomenal paces. Construction activity is slowing in many parts of the West.

#### Financial Sector

Financial institutions report generally good conditions, despite weakness in lending activity. One southern Californian bank reports declining deposit levels while another indicates that consumer, commercial, and construction loan volumes have weakened in recent weeks. One banker reports that loan activity continues to grow in Oregon and Washington, but at half of last year's pace.