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Summary of Commentary on
MAR 13 1991

Current Economic Conditions

by Federal Reserve District

March 1991

SUMMARY OF COMMENTARY ON CURRENT CONDITIONS
BY FEDERAL RESERVE DISTRICT

MARCH 1991

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Summary*

Economic activity remained soft in much of the nation but there were some indications that the decline may be slowing. The pattern of retail sales varied among districts with the majority reporting either sluggishness or results below planned levels. Retail inventories appear to be at satisfactory levels, except for some excess auto stocks. Manufacturing was sluggish in most of the country though several districts noted either a slight improvement or an easing of the downward trend. While construction activity continued weak, realtors and homebuilders reported an increase in buyer interest and, in some areas, purchases in recent weeks. The pickup was attributed to lower mortgage interest rates and more attractive home prices. Loan demand remained soft although mortgage refinancings have increased. Farm income prospects and mining output were mixed.

Consumer Spending

The pattern of retail sales varied among districts with the majority reporting either sluggishness or results below planned levels. In several areas such as Atlanta, Cleveland and San Francisco, sales fell sharply after the Persian Gulf war began and then recovered to varying degrees. In some other areas such as Richmond and New York, sales remained slow. Some districts with generally sluggish sales noted pockets of strength. Thus, in Dallas and Atlanta discount stores

*Prepared by the Federal Reserve Bank of New York and based on information collected before March 4, 1991. This document summarizes comments received from businesses and other contacts outside the Federal Reserve and is not a commentary on the views of Federal Reserve officials.

exhibited strength as did specialty stores in Philadelphia. Most districts reported that auto sales declined though Dallas and Atlanta noted some recent improvement. With the exception of some excess auto stocks, retail inventories generally appear to be at satisfactory levels.

Retailers in most districts were hopeful that sales would improve with the cessation of hostilities in the Gulf but most did not anticipate strong gains until the economy rebounds and consumer confidence returns.

Manufacturing

Manufacturing activity was sluggish in most of the nation though several districts noted either a slight improvement or an easing of the downward trend. Boston, Chicago, Kansas City, Philadelphia and St. Louis stated that strength in the export sector was offsetting a part of the weak domestic demand and Atlanta and San Francisco noted that some manufacturers' orders had increased as a result of the Gulf war. Of the six districts reporting on manufacturing inventories, four mentioned excess levels and the need for further trimming while in the remaining two, stocks were generally satisfactory. Atlanta, Boston, Chicago, Cleveland and St. Louis described a slowdown in motor vehicle production, and, related to this, Chicago and Cleveland noted a decline in steel production as well. Other industries in which activity slowed were textiles, furniture and construction-related products. On the other hand, Cleveland noted that capital goods output was holding up fairly well, though in Chicago the picture was mixed, and Atlanta and St. Louis noted strength among food processors.

Dallas described the production of oil field equipment as growing strongly. With regard to the outlook, contacts in Boston and Philadelphia anticipate an improvement in three to six months and manufacturers in the Richmond district are optimistic about the future for the first time in several months.

Construction and Real Estate

While construction activity continued weak in most of the nation, eight districts noted that realtors and homebuilders have reported an increase in buyer interest and, in some areas, purchases in recent weeks. The pickup is attributed to lower mortgage interest rates and more attractive home prices. Despite the pickup, however, most districts report that homebuilding activity remains slow and participants are only cautiously optimistic that some improvement over last year's slow pace will occur. Nonresidential construction also remained weak and with vacancy rates continuing to rise on office and retail space, contacts in most districts do not anticipate a turnaround. However, Dallas noted that several large commercial projects have begun and that petrochemical plant construction is robust.

Banking and Finance

Loan demand continued soft in the nine districts reporting on financial developments although mortgage refinancing has increased with the decline in mortgage interest rates. Both consumer and business loan demand are weak and lenders do not anticipate a rebound until overall economic conditions improve. Consumers are reportedly reluctant to add new debt given the uncertainties about the employment situation, and firms are maintaining low inventories and reducing capital spending.

However, St. Louis noted that some companies that normally obtain funding in the commercial paper market have been inquiring about bank financing. Meanwhile, lenders in some districts have tightened terms for borrowers particularly in the construction and real estate sectors.

Agriculture and Natural Resources

Dallas reported that agricultural income prospects improved due to good cotton, rice and peanut harvests and continuing strong beef prices. Kansas City noted that weak grain prices limited the income of crop producers but that the income of livestock producers was bolstered by low feed prices and continued strength in cattle and hog prices. The Minnesota index of prices received by farmers fell for the ninth consecutive month to the lowest level since 1988. San Francisco noted that the fifth year of drought in California will result in reduced production of field crops and increased production costs. Moreover, higher feed prices and a lack of adequate grazing land will force cattle into feedlots early, thereby lowering livestock prices.

Lower oil prices and uncertainty about the future have caused drilling activity in Kansas City to subside though the rig count is still about 3 percent above a year ago. Energy sector activity remained strong in Dallas where oil companies expect demand for their services to increase as Kuwait rebuilds its oil fields. Oil production in the Atlanta district was stable. San Francisco and St. Louis report that the wood products industry has weakened in response to slow overall economic activity. Mining industry conditions have been fairly good in Minneapolis with 1990 iron ore production up 5 percent, but coal production in St. Louis has declined.

FIRST DISTRICT-BOSTON

Economic activity in the First District shows signs of stabilizing, albeit at a low level. The retailers contacted report mixed sales results - about half experienced increases while others' sales declined, some by as much as double-digit percentages. According to the consensus, sales conditions will be fairly stable for the rest of 1991, forcing retailers to control costs in order to achieve adequate profitability. First District manufacturers generally describe current business conditions as weak, but half report a slight improvement in recent weeks. And most expect a modest recovery toward mid-year. According to press reports, residential real estate activity has picked up in response to lower interest rates and asking prices.

Retail

Retailers in the First District report mixed sales results since Christmas. For half the sample, sales are up by several percentage points from a year ago. For the other half, sales have declined - in some cases, by double-digit percentages. The southern half of New England is relatively weak; Maine is relatively strong. Our respondents frequently note that consumers are postponing major purchases whenever possible, but some also express relief that the economy has not deteriorated further.

The consensus among our retail contacts is that sales conditions will be largely unchanged during the remainder of 1991. To remain sufficiently profitable, retailers will be forced to keep very tight controls on costs. Some are still continuing to reduce inventories.

All are attempting to reduce labor costs through measures such as layoffs, attrition, reduction of hours, or wage freezes. (A couple note that increases in workers' compensation and unemployment insurance make it difficult to hold the line on labor costs.) Retailers' capital spending plans are modest.

Manufacturing

First District manufacturers contacted in late February generally describe business conditions as very sluggish; half see signs that demand may be stabilizing. According to this group, incoming business has improved slightly in recent weeks. Nevertheless, new orders range widely from 10 percent below to 14 percent above year-ago levels. Housing, autos and general industry are considered relatively weak markets; components for commercial aircraft, telecommunications, and instruments as well as some new products show more strength. Views on exports are also mixed. Contacts are divided as to whether exports to Europe are picking up after a weak third quarter. Exports to the Pacific remain relatively strong.

At half of the manufacturers contacted, inventories are described as somewhat too high. One-third also expect to reduce employment in the next few months. Three-quarters of the firms have already brought employment below 1990 levels, with the declines ranging from "slight" to as much as 12 percent.

Most contacts report that materials prices are stable or declining. Three have succeeded in negotiating price reductions for selected inputs. Oil-related prices peaked in the fourth quarter. The only price increase mentioned was for specialty steel imported from Japan. A majority of respondents have raised their selling prices on

selected products, with the greatest increase amounting to 6 percent. A minority are giving discounts.

Half the manufacturing firms expect capital expenditures to be unchanged from last year's level. A few plan increases of 10 to 20 percent; only one anticipates a decline. Most budgeted spending is for state-of-the-art equipment. Only two firms plan to expand capacity.

Most contacts expect prospects for the economy and for their firms to improve toward mid-year; however, they anticipate a relatively modest recovery. Positive developments cited include declining interest rates, the war's brevity and the need to rebuild Kuwait. Negative factors include "continuing financial fragility" and declines in military spending. Half expressed optimism concerning company sales or profits in 1991. Others express considerable uncertainty; however, they expect the outlook to clarify shortly, since the next four weeks should tell the tale concerning consumer confidence.

Residential Real Estate

According to press reports, residential real estate activity has picked up significantly since the beginning of the year. In the Greater Boston area, pending sales are up substantially from the depressed levels of early 1990. Realtors attribute the improvement to declining interest rates and lower asking prices.

SECOND DISTRICT--NEW YORK

Recent reports on District developments have been soft to mixed. Sales results at department stores have continued below targeted levels and District unemployment rates rose substantially in January to levels above the national average. More positively, homebuilders noted a recent upturn in buyer interest though the market remains soft, and office leasing activity stepped up. The majority of officers surveyed at small and medium-size banks reported that loan demand is generally weak.

Consumer Spending

Sales results at District department stores in January were below targeted levels though generally somewhat better than parent company's nationwide averages. Contacts reported good results early in January but a decided slowdown in sales following the start of the Persian Gulf war. However, a brief period of cold weather helped to move items such as outerwear and sweaters.

Most retailers reported over-the-year sales gains in January ranging from 0.5 percent to 3.5 percent though one chain had a year-to-year decline. Big ticket items such as furniture, rugs and other home furnishings continued to be hard hit as they have for several months. Fall and winter apparel moved well at most stores after postholiday markdowns to make room for new spring merchandise. As a result, inventories were described as on target and, in one case, below planned levels. Retailers were generally cautious about the near-term outlook in view of the recession and consumer concern about the likelihood of further layoffs.

Residential Construction and Real Estate

Homebuilders in several parts of the District report an upturn in buyer interest during recent weeks though the market continues to be described as basically soft. Potential buyers have been visiting model homes in greater numbers and prices on existing homes have fallen sufficiently in some areas to motivate purchases by first-time homeowners. Lower mortgage rates and greater optimism about the Gulf situation were mentioned as contributing factors. Many participants are now cautiously optimistic that some improvement over last year will occur. Builders continue to report some difficulty in obtaining adequate financing, however.

While District office leasing activity has recently stepped up, little or no improvement in office vacancy rates has resulted because of the continued marketing of new or no longer needed space. In fact, in mid-Manhattan, where new office towers are still rising, the vacancy rate rose by almost a percentage point between November and January and is now about three percentage points above January 1990. Vacancy rates on District retail space have also been increasing.

Other Business Activity

District unemployment rates rose substantially in January to levels above the national average. New York's rate increased to 6.5 percent from 5.5 percent in December while New Jersey's rate rose to 6.4 percent from 5.9 percent. In a separate report, the New York Department of Labor noted that during 1990, job losses in the state were greater than in any year since 1975. Further dampening the District's labor markets were announcements of yet another round of large-scale layoffs by three financial firms and the Navy's cancellation of a contract with Grumman Corporation.

Both the Buffalo and Rochester surveys of purchasing managers reported an increase in the percentage of firms with improved business conditions in January following a large decline during December. Two-thirds of the respondents in Rochester anticipate stable business conditions over the next three months.

Financial Developments

The majority of loan officers surveyed at small and medium-size banks in the District report that loan demand is generally weak, as indicated by a decline in loan applications. Most bankers noted that consumer credit is the weakest sector although business loan demand has also declined. However, respondents noted that mortgage refinancing has increased significantly as rates on fixed rate mortgages have declined relative to those on variable rate mortgages. While loan inquiries have recently increased, customers reportedly seem reluctant to take on additional debt, despite generally lower interest rates, given the uncertain economic conditions. In order to stimulate loan demand, all the banks surveyed are undertaking more aggressive advertising campaigns. However, some officers expressed doubts that such efforts will stimulate much new demand until confidence in the economy improves. Although the majority of respondents said that their standards for qualified customers have not changed over the last year, some have tightened credit requirements, particularly in evaluating applications for real estate related loans.

THIRD DISTRICT - PHILADELPHIA

Economic activity in the Third District remained sluggish in February, but there were some spotty indications of improvement. Although manufacturers said the downtrend in that sector continued, they indicated that orders and shipments have been steady in recent weeks, following a year-long decline, and export business was picking up. Realtors reported that sales of both new and existing homes had increased in February. On the negative side, retailers generally were experiencing weak sales, and bankers said overall loan demand remained slack although some noted an increase in lending to middle market companies.

Looking ahead, Third District business contacts generally express guarded optimism. Manufacturers expect an increase in activity over the next six months and they are planning some increases in capital spending. Retailers anticipate sales to pick up with the end of hostilities in the Persian Gulf, but they do not expect strong gains until overall economic activity rebounds. Realtors believe the recent improvement in sales should be sustained as long as mortgage rates do not move up and there is no substantial decline in employment in the region. Bankers, however, believe that loan demand will remain only steady, at best, until there are clear signs of resurgent economic growth.

MANUFACTURING

Reports from manufacturers in late February indicated that although industrial activity continued to slow, the downward trend appeared to be easing. Around half of the firms contacted said business was running at a steady pace and there were some reports of improvement. In particular, manufacturing executives

indicated that, on balance, total orders and shipments had been running at a stable rate in recent weeks after a year-long decline, buoyed by a pickup in export business. Nevertheless, managers at area plants said they were continuing to trim employment.

Third District manufacturers apparently see some signs of improvement, and the consensus outlook is optimistic. More than half of the plant managers queried in late February expect business to pick up over the next six months. Although most do not expect the increase in activity to be large enough to require hiring more workers, expectations of improving business conditions are prompting some area firms to schedule increases in capital spending.

RETAIL

Retailers reported that sales were sluggish in January and February. Some specialty stores have seen stronger sales recently--notably women's and children's clothing stores and stores catering to the do-it-yourself home improvement market; however, nearly all broad-line stores are experiencing softness.

Store executives said consumers have been very cautious in their spending behavior. While merchants expect some improvement with the end of hostilities in the Persian Gulf they believe that consumers will continue to exercise restraint until the employment situation improves and family incomes pick up. Retailers plan to limit expenditures for merchandise and marketing, and they are stepping up efforts to control expenses.

FINANCE

Total loan volume outstanding at major banks in the Third District has dropped since the beginning of the year. Bank lending officers describe loan demand as slack for most categories of credit, and they do not foresee a rebound

until overall economic conditions improve.

While some bankers noted an increase in lending to middle market businesses, most said total commercial and industrial loan volume continued to slip. Consumer loan volume was also down, according to Third District bankers. Several noted that outstanding installment credit was declining, especially for auto loans and credit cards. Although bankers said consumer loans usually are paid down at this time of year, some believe the decline in outstandings is greater than can be attributed to the seasonal factor alone.

Real estate loan volume outstanding is down only slightly from the beginning of the year. Bankers noted a recent pickup in new residential mortgages as well as an increase in refinancings. Some also indicated that depository institutions and other lenders were extending maturities on outstanding loans to commercial property owners and developers where the financial condition of the borrower remained sound. However, bankers said that little new permanent financing was being advanced and that practically no funds were being provided for speculative projects.

REAL ESTATE AND CONSTRUCTION

Sales of both new and existing homes have increased in recent weeks, according to realtors. Most of the improvement came in the low- to mid-priced market, but realtors also noted an increase in inquiries from potential buyers in the high end of the market. Further indications of increasing demand are reports from some builders that it was becoming easier to obtain asking prices for the houses they build. Realtors expect residential business to show continued improvement as long as mortgage rates do not move up and the employment situation does not weaken.

Commercial realtors estimated that office vacancy rates were in a range

from the mid-teens to low-twenties in business areas around the Third District, and they expect rates to remain at these levels through the rest of the year. Vacancy rates for retail space were described as high, and some real estate executives said high vacancies at some shopping centers were having a negative impact on sales at stores operating at those locations.

Realtors and executives involved in real estate financing expect construction activity to continue to decline this year. They say refurbishing of older buildings, primarily offices and warehouses, will provide some demand for construction this year and next, but they are concerned that these buildings may be at a competitive disadvantage in attracting tenants due to the large amount of recently built space available.

FOURTH DISTRICT - CLEVELAND

Summary. The end of the Persian Gulf war has not altered the outlook for a brief and mild recession, although some respondents believe that the probability of recovery by summer, along with prospects of moderating inflation, has improved. Manufacturing conditions in the Fourth District have deteriorated in recent months, but the overall unemployment rate in Ohio in January was still below the national average. The worst of the production cutbacks in manufacturing, especially in autos and steel, appear to be over. Retailers note a recent pickup in sales. Credit is still available to qualified borrowers in the District, and banks and thrifts report a recent flurry of activity for mortgage loans.

National Economy. Respondents have not changed their view that the recession will last two to three quarters and will be milder than the average of post World War II recessions. The end of the the Gulf war, raises the probability of growth instead of decline in real GNP by 1991:IIIQ, according to some respondents. Real GNP is expected to decline by nearly the same rate this quarter as last, based on the weakness already seen in January. Also, an overall annual inflation rate of about 3.5% for the balance of 1991 appears more probable now that oil prices have fallen to the pre-Kuwait-invasion level.

Regional Economy. The District's unemployment rate, although rising slowly in recent months, remained below the national average again in January.

Manufacturing continues to outperform the nation, but showed some signs of weakening in late 1990. This Bank's estimate of industrial production in Ohio fell in both November and December, and employment in manufacturing has been edging downward since late last fall. Additional layoffs in late January and February, especially in the auto and steel industries, suggest that the unemployment rate in Ohio will rise closer to the national average over the next few months, according to some analysts.

Consumer Spending. Retail sales in February apparently strengthened from January, and retailers are encouraged that the pickup in sales will carry into March and the spring season. One retailer, who ordered goods based on his anticipation that weak sales since mid-1990 would continue through the spring, now believes that the season could be better than he expected.

Nevertheless real consumer spending this quarter will likely show about a 1/2 annual rate of decline from last quarter because of the weak January performance, according to some retail analysts.

Retail inventories are judged to be about in line with desired levels. There appears to be little concern that retail inventories are excessive, except for new cars. A few retailers assert that even a mild pickup in sales would result in prompt increases in orders and production.

Manufacturing. Most Fourth District respondents still believe that the worst of the slump in industrial production occurred last quarter, and that production cuts this quarter will be smaller than last.

Inventory reduction is not expected to be quite as large this quarter. Auto stocks will be reduced again this quarter, but not as much as last. In general, the inventory buildup prior to the economic contraction was relatively small, and manufacturers have been promptly reducing stocks because of the weakness in sales.

Auto output in 1991:IIQ was cut back more than expected as recently as a month ago, and production this quarter is now estimated at a 5.0 to 5.4 million annual rate compared with a 5.5 million rate last quarter. Industry analysts report that auto dealers cut orders below sales because of weak sales in January. New car sales strengthened in February, and dealers apparently have stepped up orders. As a result of recent production cutbacks, the auto industry is operating at slightly less than 60% of capacity. New car production in 1991:IIQ should be higher than in the current quarter if orders are placed at or above sales levels.

Capital goods output has been holding up better than is typical for a business slowdown. However, heavy-duty truck output has slumped more than expected, although the bulk of that decline reportedly has already occurred. Some producers of electrical and industrial machinery are encouraged by the way orders have been holding up relative to past recessions, apparently supported by continued strength in exports and closely controlled inventories. One analyst expects that a slight reduction in real producers' equipment output this quarter will be followed by a slight pickup next quarter. A capital goods supplier also expects that its business will not slide as much as in the "average" recession.

Steel operations have fallen to about 65% of capacity this quarter in response to cutbacks in consumption and steel inventories. Steel exports have fared relatively well. While the bulk of the inventory correction is expected to be completed by the end of this quarter, reduction in stocks will continue into the second quarter, constraining output.

Credit Market Conditions. There is still little indication that qualified borrowers in the District are being denied credit, although borrowers may have to search harder and meet higher terms for loans than they did last year.

Banks and thrifts report that lower mortgage interest rates have stimulated activity for home loans, especially for refinancing, in recent weeks. Some thrifts report a surge in mortgage loan activity since about mid-February, and are hoping for at least a seasonal pickup in mortgage loans this spring. Lenders report that ample funds are available for mortgage loans. Housing affordability is judged to be the best in several years.

Lower interest rates have not yet stimulated activity for commercial and industrial loans. Some banks experienced either a slight decline or a slight increase in loans in January, because of a weakened economy.

Banks generally are avoiding construction loans, but they are still being made available to qualified borrowers. A well-capitalized thrift also reports making construction loans, including for apartments, industrial warehouses, and shopping strip malls, to qualified borrowers who were refused loans by some commercial banks.

FIFTH DISTRICT-RICHMOND

Overview

District business and financial activity apparently weakened somewhat in recent weeks, although there was a noticeable shift toward optimism about near-term prospects. Retail sales, manufacturing, real estate, tourism, and bank lending evidently declined in January and February. Exports were generally unchanged and imports rose at District seaports. Mild weather conditions likely benefited agriculture.

Survey respondents--even those surveyed before the ceasefire in the Gulf War--were decidedly more optimistic about the economic outlook than they had been a few weeks ago. Further, some who remained pessimistic believed that the economy would begin to recover when the conflict ended--a condition now apparently met.

Consumer Spending

Our regular survey of retailers suggested that retail activity softened in late January and early February. Most of those surveyed reported decreases in shopper traffic and in total sales, including sales of big ticket items. Nearly four in five reported that sales had declined since the Allied air campaign began. Employment at retail stores decreased, while wholesale and retail prices increased.

A majority of the retailers expected their sales to rise in coming months. This optimism contrasted with retailers' pessimistic survey responses a few weeks ago.

Manufacturing

Our regular mail survey of manufacturers indicated that District

manufacturing activity declined slightly in January and early February. Far more respondents reported decreases than increases in shipments, orders, and employment. Over two-thirds said poor sales were their biggest problem. Nearly half said that sales had declined since the Gulf War began, while only one in eight said sales had picked up. Most manufacturers indicated that the prices and inventories of their raw materials and finished products had remained stable in recent weeks.

Activity in the textile and furniture industries remained depressed. Several producers have gone out of business in recent months. Most manufacturers were operating on reduced workweeks. One producer expressed concern over the deteriorating quality of manufacturers' accounts receivable.

Looking forward, however, manufacturers were optimistic for the first time in several months. One-half believed that orders would increase over the next six months, while only a few foresaw a decline. Similarly, one-half expected conditions in their local areas and in the nation to improve in the next six months.

Port Activity

District ports--Baltimore, Charleston, and Hampton Roads (Norfolk)--indicated that exports were generally unchanged while imports were generally higher in January than in December. Compared with a year ago, export shipments were higher at all three ports and imports were higher at two. Authorities at all ports expected exports to rise faster than imports over the next six months.

Real Estate

Commercial and residential real estate activity apparently remained weak across most of the District during late January and early February.

Contractors and real estate analysts reported very little commercial construction in their areas. One analyst said that absorption of existing office space was slowed by the consolidations of many service-producing firms--primary users of office space.

Buyer interest in houses apparently rose, but home sales remained sluggish in most urban areas and home prices were reportedly down slightly. Sales activity was reported weakest in the most expensive segment of the market and generally stable in the lower-priced segments.

Tourism

A telephone survey of hotels, motels, and resorts indicated that tourist activity was below average this winter. Over half the respondents experienced declines in room occupancy while one-third noted little change. The slow tourist business was attributed to the Gulf War, the general economic slowdown, and the lack of snow for skiing. The respondents expected business to improve, however, in the months ahead.

Finance

District financial institutions contacted by telephone reported that loan volume and interest rates were lower in recent weeks. Loan demand was also down compared with a year earlier. Almost all of those contacted reported extremely slow commercial real estate loan activity, with little borrower or banker appetite for loans. Bankers cited uncertainties related to the Gulf War and sluggish economic conditions as reasons for the slowdown in consumer loans. Several bankers said that the recent economic downturn had dampened consumers' willingness to borrow. One Northern Virginia banker, however, reported a large increase in residential mortgage applications in the days leading up to the ceasefire, and several thought demand would pick up

somewhat in coming months.

Almost all of the bankers expressed a belief that current lending standards were prudent and, for the most part, not causing creditworthy borrowers to be refused credit. Several said, though, that appraisal costs and the lengthy approval period for mortgage loans may have caused some potential borrowers to withdraw applications.

Agriculture

Farm analysts reported that mild winter weather had generally benefited small grains and lessened the drawdown of winter hay stocks. Mild weather apparently helped many District farmers begin spring planting preparations earlier than usual and also may have boosted survival rates of winter calves.

SIXTH DISTRICT - ATLANTA

Overview: Reports from businesses contacted in February were more mixed than has been the case in recent months. While manufacturing activity levels were below or barely equal to those seen a year ago, several retailers and residential realtors have seen either a bottoming out or slight pickup in recent weeks. Producers in construction- and transportation-related industries reported no signs of improvement. Some current offset in the generally weak construction sector is provided by work on a number of large industrial and government projects, and rising home sales. Industries related to agriculture and energy are experiencing growth or remain stable. Oil price declines this year have allowed some firms to restore profit margins and others to lower prices. Reports from bankers indicate that consumer and commercial lending remains sluggish.

Retail Sales: Retailers report that sales dropped dramatically during the first week of the Gulf war but that they rebounded after that time. Overall, retailers said that January and early February retail sales fell below or only equalled last year's levels. Contacts reported that durable goods sales continued to decline, and a few contacts noted a drop in their historically strong catalog business. Most merchants said they were cautiously ordering durables because they expected sales to be lackluster at least until spring. However, discount stores continued to report strong sales, particularly for nondurables, and were ordering more aggressively than last year. Auto dealers, meanwhile, have reported improved sales recently following an initial deep plunge at the beginning of the war. An Atlanta dealer emphatically said "we have seen the bottom." The convention business in Atlanta and Orlando is reported to be down while New Orleans' convention attendance levels are up slightly from "solid" year-earlier figures.

Manufacturing: Producers in several important regional industries report declining or flat sales in January and early February compared to year end; they say that soft orders suggest

that improvement is not yet imminent. Declining orders caused a heating and air conditioning company to reduce its 1991 sales forecast by 5 percent recently, and cut its employment level by 10 percent. Home furnishings manufacturers, textile and auto producers, and auto parts manufacturers say that they are responding to bleak sales with further layoffs and plant closings. A jet engine parts maker, previously producing near capacity, reports that expected airline and military spending cuts will result in a significant number of layoffs at its southeastern plants. Formerly strong exports of pulp, paper, and chemicals now are reported to be softening. This export slowdown is reflected in a report by a power generation equipment producer which indicates that new orders from pulp and paper producers are down. Generally, businesses report cutbacks in capital spending, though a majority say these are temporary.

Other significant industries report stable or growing sales. Producers of military boots and camouflage apparel say their order backlogs have lengthened and that they are expanding their work forces in order to fulfill growing military demand. Contacts say that stronger markets for agricultural products have strengthened sales of fertilizer and other farm supplies. A sugar processor says that its 1990 sales were up 18 percent from 1989. A poultry-processing firm reports that stronger demand for its product by fast food stores has bolstered production and sales. Oil producing activity reportedly has remained stable throughout the steep price swings of the past half year.

Financial Services: Bankers report flat business and consumer loan demand in January and early February compared to the last reporting period, and attribute it to a general lack of confidence in the economy. Contacts say that commercial loans were flat because firms have maintained low inventories and reduced capital spending. However, a major regional bank's working capital lines are reported to be growing due to its easing of credit terms. Banking contacts say that lending conditions still are tight for some borrowers, particularly for real estate

development. Borrowers representing stable industries such as utilities report that credit market conditions are favorable.

Construction: Commercial construction and homebuilding activity across the region remain at levels well below those of a year ago and of recent months. Commercial construction, except for a number of industrial projects, was described as "dead" by a large building materials manufacturing company that has already cut its work force by 30 percent over the past year. According to other contacts, a number of large highway and other government construction projects that are underway across the region should offset some of the weakness in commercial construction. Additionally, realtors report improvements in existing home sales in January and February, and they indicate that overall home sales probably have bottomed out.

Wages and Prices: Recent oil price declines have been passed through to customers in industries with automatic adjustment clauses such as utilities and some transportation companies. Others, however, are still putting through lagged adjustments to earlier increases. Prices for fertilizers and some other energy-intensive products are even reported to be rising. Contacts in some transportation companies say they are rebuilding previously squeezed profit margins. A refrigeration machinery company contact reports that his suppliers seem to be benefiting from lower energy costs and are holding prices steady. Business contacts generally report easing wage pressures. Technical workers such as welders still are reported to be scarce in Louisiana while there is a growing pool of plumbers, electricians, and other building trades workers in the region due to construction's decline.

SEVENTH DISTRICT--CHICAGO

Summary. Economic activity in the Seventh District continued to contract in February, but contacts from several sectors reported that indicators have begun to show signs of bottoming out. Retail sales generally remained soft in February and early March, although several sources stated that the pattern of sales within the month of February may have hinted at the beginning of a recovery. Sales and production in the auto industry continued to be depressed, but a turnaround is still expected next quarter. Reports from capital goods manufacturers were mixed, with weakness in computer-related and heavy equipment and strength in machine tools. District steel production reflected weakness in construction and equipment demand, as well as in auto production. Bank reports indicate that both borrowers and lenders remain reluctant to commit to new lending agreements, despite lower interest rates. However, lower rates may be sparking new activity in the residential real estate market.

Retail Sales. District retail sales activity remained soft in February and early March. However, several reports suggest some signs of resilience after the marked weakness experienced in January. One large department store chain stated that District sales in February continued to show year-over-year declines, in line with results for the nation as a whole, although the pattern of sales within the month hinted at a bottoming out. A large catalog retailer stated that orders showed an uptick once hostilities ended, but it was too early to tell whether this reaction warranted modifying the firm's cautious stance on orders to manufacturers. Two large general merchandise retailers based in the District reported little sales improvement immediately after the cease-fire in the Middle East. One major discount retailer reported that District sales were above inflation rates during February. This retailer's sales gains in the District were also roughly in line with performance nationwide. Sales improvement may be in part the result of bankruptcies at other discount outlets, but sales were still strong enough to suggest that the decline in consumer spending is bottoming out, according to this retailer.

Autos. Motor vehicle sales in the District remained depressed in both January and February. Several auto dealerships stated that, following an extremely weak period in early January, sales and traffic picked up briefly after the United States launched military action. Few dealers contacted reported any significant sales increases in the brief period since the cease-fire, although several stated that consumer attitudes and traffic levels improved measurably, leading to hopes that the month of March will show a solid turnaround in sales. A large dealer of cars sold to upper-income customers reported that sales fell 60 percent in January and 50 percent in February from the year-earlier periods, in part due to new taxes.

Another dealer, who characterized his customer base as relatively stable, also reported sharply weaker sales in January, with no sign of a turnaround in February. This contact stated that consumers are increasingly insensitive to incentives. One dealer argued that the decline in interest rates has not yet passed through to the auto-buying consumer, as many financially-pressed lenders have simply captured a higher spread. Still, lower interest rates have helped by lowering inventory financing costs.

Increasingly frequent downward revisions to announced auto production schedules have hurt inventory planning for dealers as well as parts suppliers. Car production increased during the month of January in both 1990 and 1991. However, production in early to mid-February 1991 turned downward again, in contrast to continued improvement over the same period last year. One industry analyst reported that current schedules still call for an increased production rate (seasonally adjusted) in the second quarter over the first quarter, in anticipation of a sales rebound. However, a large dealer expressed concern that the recent acceleration of fleet sales will provide an overhang of "nearly-new" used cars, dampening a production turnaround in the event sales rebound soon.

Capital Goods. Reports from capital goods producers are mixed, with some contacts reporting continued weakness since the beginning of the year and others holding firm. A large manufacturer of communications equipment stated that new domestic orders began to show year-over-year declines in January, and the company was starting to experience some order cancellations. Order growth had been slowing since the latter half of 1990, but the rate of decline in January orders was not as severe as experienced in early 1987. A manufacturer of a wide variety of capital goods, who had experienced solid growth through much of 1990, reported a sharp decline in orders for nondefense machinery in January. However, a small producer of electric engines reported strong export-based orders, resulting from the relative weakness in the dollar. A District steel producer reported that orders from capital goods producers, such as farm equipment and most forms of industrial machinery, remained soft through February. However, orders from machine tool producers were strong, along with orders from those manufacturers who enjoyed solid export growth potential.

Steel. After holding up relatively well through the end of 1990, steel production fell significantly in January and early February, and the industry's operating rate fell to about 65 percent in early February (compared to 85 percent in the year-earlier period). A large District steel producer reported that production has begun to pick up shipments, following some inventory building in December. According to

this contact, steel suppliers to the auto industry are increasingly cautious about maintaining inventory at levels sufficient to respond quickly to an auto production turnaround.

Price erosion contributed to poor steel industry profits in 1990 and may continue to hold down profits this year. One senior executive expressed optimism that the industry would benefit from price increases, which officially became effective in early 1991. However, part of the proposed increase has already been rolled back. Some industry analysts are projecting continued price erosion in 1991, citing increased competition to meet slowing domestic demand.

Credit Developments. Several District loan officers reported further tightening in loan terms for commercial and industrial customers in early 1991. Tightening most often took the form of higher spreads, smaller credit lines, and increased credit-line costs. These actions were reported more frequently, and with greater magnitudes, for lending to large borrowers than to small borrowers. Because the new tightening in credit-line terms only applies to new lines of credit, the ultimate impact on total credit-line utilization may not be felt immediately, according to several financial analysts. One District banker, who reported little change in lending policy, also cited weak demand as contributing to slow lending activity. However, this contact stated that potential commercial and industrial customers seemed to be "shopping around" more often for the bank offering the best terms.

Construction and Real Estate. Lower mortgage interest rates may have recently helped to spark some activity in the residential real estate market. Several District sources reported higher levels of inquiries in recent weeks, which may translate into increased home resale activity in coming months. One large District realtor reported that residential transaction volume declines seemed to level off somewhat in January. The rate of decline in February was at a much slower pace than in late 1990, and inquiries began to increase. Most new business has been generated by first-time home buyers.

Several contacts noted that interest rate declines are not a key factor in today's commercial market, as institutional investors remain reluctant to provide capital for new projects. One large retailer stated that the firm's new store expansion program was being held back, not for strategic reasons or internal cash flow problems, but by the inability of shopping mall developers to obtain financing for new projects. A structural steel fabricator stated that architectural firms continue to cut back on employment, a sign that a turnaround in sales of construction materials is not in sight. Industrial properties remain the strongest in the commercial market, however, and have recently been viewed more favorably by investors, according to one commercial realtor.

EIGHTH DISTRICT - ST. LOUIS

Summary

District economic activity continues to contract, but not as sharply as indicated in our preceding report. Retail sales, though still depressed, show signs of improvement. Durables manufacturing activity continues to weaken, but declines are mitigated by export growth. Demand for transportation services generally is weak. Declines in residential construction and sales appear to have bottomed out. Loan growth, while still weak, has shown some improvement. Activity in natural resource industries is weak.

Consumer Spending

Recent retail sales are near or slightly below their year-earlier level; in many cases, substantial price cuts were used to move goods. Some retailers, however, report slight sales increases which they feel reflect rising consumer confidence. Many retailers expect March sales to improve, but only slightly. Typical responses regarding recent motor vehicle sales were "quite poor" and "almost nil." Some dealers are cutting inventories by reducing orders. Contacts believe sales are depressed because many consumers have a "wait and see" attitude.

Manufacturing

Many durables manufacturers making products related to autos, construction and appliances continue to receive declining orders. For instance, a Kentucky steel mill is cutting production substantially. Vehicle assembly plants in St. Louis and Louisville ordered temporary layoffs in response to rising inventories and weak sales. In St. Louis, contacts anticipate the elimination of jobs by defense contractors and motor vehicle producers, layoffs by other manufacturers and the lack of

growth in most other sectors will result in declining employment levels throughout most of 1991. While inventories of most manufacturers are near desired levels, an increasing minority of producers, including those making rubber insulation and copper tubing, report excessive inventories.

Recent experiences of nondurables manufacturers have been mixed. A shoe manufacturer reports that orders have been soft since June; the outlook is uncertain because customers have been slower than usual in making commitments for the Fall season. Meanwhile, food processors continue to receive steady or rising orders.

Exports

For many manufacturers, including those producing boxes, electrical components, wire and wood products, rising sales to foreign markets have partially offset the loss of domestic orders. Sales to Mexico and some European markets are especially strong. Contacts believe the resolution of the Persian Gulf war will stimulate exports to the Middle East. The level of southern pine lumber exports is reported as steady, while District crop exports, except wheat, have fallen.

Transportation and Distribution

One airline in St. Louis has ordered layoffs, while another has pulled out of the Memphis market. Both actions are partially in response to a reduction in the demand for air service stemming from the Gulf war. Air passenger traffic is flat in Louisville and below year-ago levels in Little Rock and Memphis. Recent air cargo shipments are up in both Louisville and Memphis, compared with a year ago, but barge traffic on District rivers is down. Orders for pallets, a barometer of future shipping, continue to "nose-dive."

Construction and Real Estate

Single family housing starts in the District were substantially below their year-ago level in January; however, some District contacts believe the downturn in the residential market has bottomed out. Realtors in Louisville, St. Louis and Memphis report increased buyer interest due to lower interest rates and a rise in consumer confidence. One Memphis contact said continued difficulty in obtaining financing was forcing developers to reduce inventories and some developers fear a shortage of new homes if financing difficulty persists.

Banking and Credit

Total loans on the books of large District banks showed a smaller decline from mid-January through mid-February than they did for the previous month. Smaller declines in real estate and consumer loans appear largely responsible for the improvement. Total loans for a sample of small and mid-size District banks show similar trends. Contacts blame weak new car sales for consumer loan softness. Loan officers report mixed activity in commercial lending. A St. Louis banker said a number of companies that normally obtain funding in the commercial paper markets were making inquiries about bank financing.

Natural Resources

Year-to-date District coal production is down 11 percent from a year ago. Abnormally high stockpiles of coal at utilities, reduced demand for high-sulfur coal and slow growth in electric output contributed to the decrease. Both southern pine lumber mills and hardwood products manufacturers report that orders are down substantially from a year ago due, in part, to weak home building.

NINTH DISTRICT - MINNEAPOLIS

Ninth District economic activity has generally declined, though there are some areas of strength. Labor market conditions have been mixed. General merchandise sales have ranged from declines relative to a year ago levels, to slight increases. Automobile sales and housing construction are down from a year ago. Conditions in manufacturing, construction, and resource-related industries have been mixed.

Employment, Wages, and Prices

Labor market conditions have been mixed, with North and South Dakota showing slight gains, while the rest of the district has generally deteriorated. The unemployment rate has fallen in North Dakota to 3.8 percent in December from 4.1 percent a year ago, while in South Dakota it fell to 3.2 percent from 3.7 percent over the same period. In contrast, the unemployment rate in Montana rose to 6.8 percent in December as compared to 5.3 percent a year ago, while that in the Upper Peninsula of Michigan rose to 9.3 percent from 8.8 percent over the same period. The unemployment rate continued to rise in Minnesota reaching 5.4 percent in January of 1991, up from 4.9 percent a year ago. Total employment in the district was generally higher than a year ago. In Minnesota, both total and nonfarm employment was about 1 percent higher in December of 1990 as compared to a year ago, due in large part to strong growth in the service sector. However, employment in construction and manufacturing have declined during the past year. In both North and South Dakota as well as Montana employment grew in almost all sectors over the past year.

Consumer Spending

District retailers of general merchandise generally report disappointing sales relative to their expectations. Retailer reports of January sales in comparable stores ranged from 1.2 percent higher

to 6 percent lower than in January 1990. Retailers generally attributed the flat sales to uncertainty about the economy and the Gulf war. However, some retailers felt that the apparent end of the Gulf war might have a positive effect on consumer attitudes. North Dakota recently reversed a more than century-old ban on Sunday retail sales.

New car sales have been mixed in February with most dealers reporting declines, though one dealer reported a 2 percent increase over the same period a year ago. Dealers expressed optimism about the near future, but noted a trend towards smaller cars. Used car sales in the district are reported to be strong. District truck sales have declined sharply with dealers reporting February declines ranging from 20 to 33 percent relative to a year ago. Dealers' reports on car and truck inventory levels range from moderate to high.

Housing has continued to be depressed in the district. In Minnesota housing permits fell to a six year low in December of 1990, down 13 percent from a year ago, and 43 percent from two years ago. A recent study of housing in the Minneapolis-St. Paul area predicted that housing sales will continue to be low due to stagnant population growth and an oversupply of existing units.

Tourism activity has been moderate to good, with some signs of weakness. Local tourism officials have expressed some hope that with the recent reductions in international travel may benefit the area. Ski resorts in Montana and parts of Wisconsin report fairly good snow conditions, while those in the Upper Peninsula of Michigan report that insufficient snow has slowed business. However, general tourist activity in the Upper Peninsula has been fairly good. The number of crossings over the Mackinac Bridge onto the Peninsula in 1990 was almost 7 percent higher than the previous year. Tourism was also up in South Dakota, especially the Black Hills and Badlands areas.

Construction and Manufacturing

Conditions in the district's construction industry have been mixed. The continuing overhang of office space in the Minneapolis-St. Paul area has depressed construction activity in the area. This overhang will be increased by the completion of four new office buildings, currently under construction.

The status of the district's manufacturing industries has been mixed lately. An index of economic activity in the Minneapolis-St. Paul area dropped in December from its November level, though it ended the year slightly above last year's level.

Resource-Related Industries

Ninth district conditions of resource-related industries have been mixed. For the ninth consecutive month, the Minnesota index of prices received by farmers fell. The mid-January level is the lowest since 1988. Wheat and milk prices accounted for a significant portion of the decline. Dairy farmers, in particular, are reported to be doing poorly. Cattle prices have remained strong however, and ranchers in the district report that 1990 was an excellent year. Precipitation in the district has been below normal, which could adversely affect 1991 crop yields. The district's mining industry conditions have been fairly good. For example, iron ore production in Minnesota in 1990 was 5.1 percent higher than in 1989.

TENTH DISTRICT - KANSAS CITY

Overview. Growth in the Tenth District economy has slowed somewhat, due in part to weaker performance in the agricultural and energy sectors. District farmers are cautiously limiting their purchases after making modest financial gains last year. And, drilling activity in the district has slipped in recent weeks due to tumbling oil prices and uncertainty about the future strength of OPEC. On the positive side, manufacturers' export sales are increasing modestly and retail sales are flat to improving slightly.

Retail Sales. Retailers generally report flat to slightly improving sales. While consumers are still steering clear of big ticket items, they are buying more apparel. Retailers are keeping prices generally stable, except for special promotions, to keep from discouraging customers further. Most retailers are generally satisfied with their inventory levels and are continuing to keep them low even though banking on improved sales after the Persian Gulf War.

Auto sales are down in almost all parts of the district. Adequate dealer financing is available, but some potential buyers are having difficulty getting loans. Weak sales are frustrating dealer efforts to trim inventories. Respondents expect auto sales to remain flat over the next two to three months before gaining strength.

Manufacturing. Most purchasing agents report moderate increases in input prices, with only scattered reports of larger price increases. In the near term, agents expect prices to be relatively stable as inputs appear to be readily available. Most firms continue to trim inventories. Some firms report slightly higher export sales and expect further increases during the rest of 1991 due to economic growth abroad and the weaker dollar.

Energy. Oil prices have tumbled to pre-invasion levels due to abundant crude oil supplies and the winding down of the Gulf War. Lower oil prices and uncertainty about the future strength of OPEC have caused district drilling activity to subside in recent weeks. The average number of operating drilling rigs in district states fell from 295 in January to 263 in February. Still, the district rig count remained about 3 percent above its year-ago level.

Housing Activity and Finance. Housing starts over most of the district were even with the previous month. While starts are still below year-ago levels, most builders expect an increase during the second half of the year. Construction materials are readily available with few reports of price increases. New home sales and prices are mixed, as is the outlook for new home sales. Most district thrifts report continued deposit outflows. Mortgage demand is weak, with some increase in refinancings due to recent declines in mortgage rates. Respondents expect rates to stabilize after falling slightly over the next few months.

Banking. Most commercial bankers report loan demand lower or unchanged compared with last month. Demand for commercial and industrial loans, commercial real estate loans, and construction loans was down at several banks and unchanged at most others. In contrast, demand for home mortgages and agricultural loans was constant or up at most banks. Demand for consumer loans was generally steady. Loan-deposit ratios were unchanged from last month at most banks.

Most reporting banks lowered prime interest rates last month, and nearly half of the reporting banks expect further declines in the near term. While consumer lending rates were unchanged at most banks, half of the banks expect to lower rates in the near term. Nearly all banks reported terms of lending

unchanged from last month. Deposit behavior varied considerably during the past month, across both reporting banks and categories of deposits. About equal numbers of banks reported higher and lower demand deposits, while MMDAs were up at most banks. In contrast, large CDs were constant or down at most banks. Changes in other kinds of deposits varied widely.

Agriculture. Spring credit reviews show modest financial gains overall by district farmers during the past year. The results of the reviews, however, differed markedly for crop and livestock producers. For crop producers, weak grain prices limited incomes. For livestock producers, low feed prices and continued strength in cattle and hog prices bolstered incomes. Although most banks have not changed their credit standards since a year ago, some banks are examining loan requests from grain producers more closely.

Capital expenditures by farmers in the district are down from a year ago. Many farmers have limited their spending to necessities and purchases of used rather than new equipment. Prospects of weak grain prices, higher production costs, and smaller government payments are probably responsible for reining in capital spending.

The condition of the winter wheat crop varies across the district. Cold, dry weather in recent months has left the crop in poor condition in parts of Oklahoma and Kansas but in good condition elsewhere. Normal yields are attainable in most of the district if sufficient rainfall is received during the remainder of the growing season.

ELEVENTH DISTRICT--DALLAS

While output in the District remains sluggish, there is little evidence of recession. In recent months, however, the national downturn has affected manufacturing industries in the District, causing a moderate decline in overall manufacturing output. The service sector continues to grow mildly. Despite falling oil prices, the energy industry is growing strongly. Construction continues to grow moderately. Retail sales are generally down. Auto sales have recently increased. Agricultural conditions have improved. State governments continue to struggle with revenue shortfalls and increased demand for services.

Manufacturing output has declined moderately since the last survey. Weakness in the national economy has reduced orders for primary metals, paper, chemicals, refining and construction-related materials. Despite these decreases, most respondents say that inventories are at desired levels. Producers of primary metals note a significant reduction in domestic orders, although gains in exports have partially offset these declines. Paper producers say that orders for corrugated boxes and printing paper have fallen noticeably. Orders for chemicals have edged down from high levels. Although prices for refined products have fallen, producers say that demand has continued to slide due to the gasoline tax and to high inventories held by customers. Lumber and wood producers generally note continued sales declines. Stone, clay and glass producers say that construction declines in the Northeast and West Coast have reduced their orders. While demand for concrete has declined, producers note that the imposition of import fees on Mexican concrete has increased District production. Orders to electronics firms

continue to grow mildly. Oil field equipment production is growing strongly and producers expect demand to accelerate with the rebuilding of Kuwait. Apparel producers note slight but unexpected improvement in orders.

Overall, the service sector continues to grow at a mild pace. Health care respondents say demand is growing strongly. Advertising firms say that orders have gone from increasing to flat due to the war in the Middle East. Petrochemical plant expansion has increased the orders for architectural and engineering firms and several firms expect strong increases from the rebuilding of Kuwait. Business consulting firms note flat overall sales. Law firms note some pick up in corporate demand, although their employment remains flat to slightly down. Temporary employment agencies report steady increases in demand. Hotel occupancy has been flat.

District energy respondents note that the current oil prices are consistent with supply and demand fundamentals. Despite falling oil prices, energy sector activity in the District is still strong. Oil and gas extraction and oil field service companies expect demand for their services to increase as Kuwait rebuilds its oil fields. Respondents in Texas say that outlays for production will be favored over exploration in 1991.

Construction activity continues to increase moderately. Single-family building has improved. One respondent notes that sales have increased in the last 30 days, after sluggish sales and starts since October 1990. Multi-family residential demand remains steady and rents and occupancy rates continue upward. The nonresidential construction sector recently has increased slightly, after bad weather and war uncertainties slowed demand in January. Several large commercial projects have begun in the Dallas area, and

petrochemical plant construction is robust in the Houston area.

General merchandise stores report that retail sales have fallen on a year-over-year basis. Discount stores, however, continue to do well although competition is stiff. Respondents say that selling prices are not keeping pace with reported inflation rates. Retailers are keeping inventories small. Sales are expected to pick up after a resolution in the Middle East. Houston sales have weakened slightly but remain strong.

Auto sales picked up in February and dealers are optimistic about spring sales. In January, Dallas-Fort Worth area auto sales fell 20 percent from a year earlier. Sales of both domestic cars and imported autos dropped, but sales of transplants--Japanese cars built in North America--increased 25 percent. Houston area sales were up 5 percent in January.

Agricultural income prospects have improved because of surprisingly good cotton, rice and peanut harvests. Furthermore, beef prices are continuing to show strength. January crop prices, however, were 5 percent below a year ago. Lower prices for corn, cottonseed and wheat offset higher prices for cotton, hay, sorghum and soybeans. The 1991 winter wheat crop will likely decrease from last year. Producers have seeded 10 percent less acres--the smallest acreage planted since 1979.

State governments report increased fiscal pressures from slow revenue growth and few areas to cut spending. In Louisiana, two-thirds of the state's budget is dedicated, and higher education and public health make up most of the other third. Texas faces a projected \$4 billion budget shortfall. Revenues are projected to increase only two to three percent in New Mexico while the state is under pressure to hire more teachers and increase wages.

TWELFTH DISTRICT -- SAN FRANCISCO

Summary

Economic conditions in the Twelfth District are reported to be sluggish, but western business leaders' outlook for future economic conditions improved for the first time since August 1990. Price and wage increases remain moderate throughout the District. Retail sales slowed substantially immediately following the outbreak of the Gulf War, but activity has picked up since then. Manufacturing activity is mixed in the West, with some firms reporting increased orders for war-related products. The District's agriculture and forest product industries continue to face difficult conditions. Construction and real estate activity remains slow in much of the West. District financial institutions report a drop in loan demand in the past several months.

Business Sentiment

The economic outlook of western business leaders improved slightly in February, although expectations about future economic growth remained pessimistic. Seventy-three percent now foresee a national recession in the coming year, compared to 81 percent in January and 75 percent in November. Expectations about business investment, housing starts, and consumer spending improved for the first time since last August. Business leaders' outlook for inflation continued to improve, with 53 percent now expecting inflationary pressures to ease in the coming year. Almost 60 percent of respondents now project improvement in the foreign trade balance during the next twelve months, compared to 29 percent in January.

Wages and Prices

Reports from throughout the Twelfth District indicate that prices have stabilized recently, and wage increases remain moderate. Prices have declined for many agricultural and natural resource products, including livestock, wheat, timber, natural gas, and oil. Increases in prices for department store merchandise remain in the 3 to 4 percent range. Health care costs, however, continue to rise at a

15 to 20 percent rate. Recent union contracts for a wide range of industries in the Northwest brought wage increases from 2 to 4 percent. Wages in financial institutions are reported to be rising at or below last year's rate.

Retail Trade and Services

Twelfth District retail trade activity declined sharply immediately following the outbreak of the Gulf War in mid-January, but many reports indicate a slight rebound since then. One District auto dealer reported that sales came to a halt for 3 or 4 days after the start of the war, but that showroom traffic has picked up recently. Similarly, department store sales softened in mid-January, but also have improved in recent weeks. The war reportedly further eroded consumer confidence, leaving buyers more cautious. Reports indicate that Southern California continues to post the weakest retail sales in the District.

The rise in consumer uncertainty also has affected the tourism industry in some parts of the West. In Hawaii, tourism has dropped off sharply, leaving the hotel occupancy rate down approximately 30 percent.

The District's media industry is facing difficulties as a result of weakening economic conditions and the war. Newspaper advertising, particularly national accounts, continues to fall off significantly at the same time that costs are rising as a result of expanded Gulf War coverage. Television advertising also has dropped off, as advertisements were canceled at the start of the war, and expanded network coverage cut into available advertising spots.

Manufacturing

Manufacturing activity in the West is reported to be mixed. Defense-related manufacturing remains weak overall, although some companies report a pick-up in activity related to the Gulf War. War-related orders range from engines for missiles to processed food products. Several District manufacturers report increasing interest from overseas buyers, including Eastern Europe, Latin and

South America, and the Middle East. Business investment plans for many manufacturing firms in the District remain cautious.

Agriculture and Resource-Related Industries

Difficult conditions continue for the District's agriculture and forest products industries. The fifth year of drought in California will result in reduced production of field crops and increased production costs. Higher feed prices and lack of adequate grazing land will force cattle into feedlots early, lowering livestock prices. California farmers with access to Colorado River or Sacramento Delta water, or who have their own wells will likely come through the drought in good shape. For many others, reduced production may be partially offset by rising prices for their products.

The District's wood products industry continues to weaken in response to slow economic activity. Western lumber production is reported down 24 percent in the first five weeks of 1991 from the same period a year ago. Orders and shipments of pulp and paper products also are reported off significantly from last year. Soft demand has left prices lower, with lumber prices down 8 to 12 percent, and pulp and paper prices off 19 percent from a year ago.

Some firms in the Northwest with expertise in oil spill clean-up will be involved in the effort to handle the spill in the Persian Gulf.

Construction and Real Estate

Construction and real estate activity remains weak in much of the West. In California and Washington, both commercial and residential construction continues to soften. Developers report increasing difficulty in obtaining financing for real estate projects. Slowing real estate sales have cooled housing prices in Los Angeles and Seattle. In Salt Lake City, however, home prices and rental rates continue to rise. New apartment buildings in Oregon report vacancy rates of less than 2 percent.

Financial Institutions

Financial institutions in the District report difficult conditions. Loan demand in much of the

West has slowed significantly. Bankers admit to tightening credit standards, and report that highly leveraged companies and speculative real estate projects will face difficulty obtaining credit. The bankers insist that loans are readily available to borrowers with strong balance sheets and solid cash flow. Many reports suggest that weak economic conditions combined with closer regulatory scrutiny have caused this tightening of credit standards.