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Summary of Commentary on _____

Current Economic Conditions

by Federal Reserve District

March 1997

SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICT

March 1997

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SUMMARY¹

District economies generally continue to expand at a relatively moderate pace. Retail sales are up in most districts from a year ago. Most districts report high levels of manufacturing activity, with only pockets of weakness. Tight labor markets still dominate in almost all parts of the country. Nevertheless, wage gains generally remain moderate. Price pressures, such as those reported by most retail and manufacturing contacts, appear to have been temperate. Most districts report strong residential real estate markets, with many citing increases in year-over-year building permits, increases in new or existing home sales and rising home prices. Commercial real estate markets continue to strengthen, with many districts reporting declining vacancy rates, rising rents and new nonresidential construction activity. Loan demand conditions are decidedly mixed across districts in all major categories of loans—commercial, consumer and real estate. Most districts report that prospects for livestock producers have brightened recently. Despite moderate drops in oil prices, activity has picked up noticeably in the energy extraction industries.

Consumer Spending

Most districts report that January and February sales are up from one year ago. The Atlanta, Boston and New York districts report that sales have exceeded expectations. The San Francisco district describes sales growth as moderate, while the Cleveland district reports retail conditions as essentially unchanged from its previous report. Apparel has been a strong seller in the Atlanta, Chicago, Kansas City and New York districts; however, apparel sales are down in the Boston district and unchanged in the Richmond district. Cosmetics, building materials, pharmaceuticals and home

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furnishings are also strong sellers, according to contacts. The New York district reports that a “tax-free” week in New York City spurred sales, but severe winter weather in the Minneapolis and San Francisco districts hampered sales at many local stores. Current inventories are generally at or slightly below desired levels.

Vehicle sales are mixed across districts. The Kansas City district reports slightly higher auto sales levels, while the Minneapolis district notes strong sales of pickup trucks. Car sales in the Philadelphia district remain unchanged, while the Cleveland and Dallas districts note slower-than-expected sales. Vehicle inventories are generally adequate, although a few reports of shortages of popular vehicles have been received.

Manufacturing

Most districts report that manufacturing activity remains at a high level and is, in many cases, growing. Pockets of weakness, however, are interlaced with this growth in many districts. The Dallas and Richmond districts report their manufacturing sectors as either “still in a seasonal lull” or down slightly. The Minneapolis district, on the other hand, describes its manufacturing sector as “hale and hearty.” The St. Louis district notes that even though the level of activity has not changed much from the last report, contacts are still optimistic about the near term.

Auto suppliers in both the Atlanta and Boston districts and heavy-duty truck manufacturers in the Chicago and Cleveland districts report strong business, while the San Francisco district notes that the aircraft and high-technology industries in the Pacific Northwest are expanding. In the Philadelphia district, metal and chemical products are showing recent strength, while furniture and home furnishings producers in the Boston, Chicago and St. Louis districts report that orders are up.

Most districts are experiencing an ongoing contraction in the apparel industry, with some of

this production heading overseas. Several districts also note that their paper and textile industries are in decline. The New York district notes a moderate slowing of manufacturing activity in New York City, and the San Francisco district reports that the electronics industry in California has slowed somewhat. Growth in the steel industry is slowing in the Chicago district, while remaining strong in the Cleveland district.

Labor Markets

Contacts in almost every district report difficulty finding and retaining new workers because of tight labor markets. Shortages of engineers and construction, skilled manufacturing and high-tech workers are most often noted. The Boston and Dallas districts report that temporary employment agencies are also having difficulties finding workers. The San Francisco district reports worker shortages in the hospitality industry, but notes a surplus of financial-sector workers because of consolidation in the banking industry. A survey of manufacturers in the Philadelphia district found that about 40 percent plan to hire employees in the near term, while a survey of businesses in the St. Louis district found that 20 percent are looking to hire.

Wages and Prices

Despite tight labor markets in nearly every district, nominal wage gains show no signs of breaking out of the 3 to 4 percent range that has been cited in the last several reports. Pockets of persistently upward wage gains associated with fast-growing sectors and regions remain, however. In particular, wage pressures remain in the Chicago district but are most pronounced at the upper end of the pay scale, while the Minneapolis and San Francisco districts report sector-specific wage increases tied to the high-technology and aircraft sectors. The Dallas and Kansas City districts, on the other hand, report a lessening of wage pressures.

Aside from higher raw materials prices reported in a few districts, price increases at retailers and manufacturers—both on the input and output side—have generally been temperate, as many districts report that competitive pressures have stemmed price hikes. The Boston, Cleveland, New York, Philadelphia and Richmond districts report that retail prices are “mostly flat” or “steady.” Moreover, in the Atlanta, Boston and Cleveland districts, wage and input price advances have been offset or negated by increased productivity gains. Materials and finished goods prices have reportedly accelerated in the Atlanta and Richmond districts; however, contacts suggest that these increases may be temporary.

Construction and Real Estate

Most districts report strong residential and even stronger commercial real estate markets. Contacts in the Minneapolis, Philadelphia, Richmond and San Francisco districts report increases in single-family residential construction. Contacts in the Boston, Chicago, Cleveland and St. Louis districts also report strong residential market conditions. Mild winter weather is credited for some of the strength in the Boston, Philadelphia and Richmond districts, while poor weather is blamed for moderate weakness in the Chicago and Dallas districts. The Atlanta and Kansas City districts report little change in year-over-year construction activity. Sales of new or existing homes are reported to be up in the Kansas City, New York, Philadelphia, Richmond and San Francisco districts. Slight price increases, some due to increases in material prices, are reported in the Boston, Minneapolis, Philadelphia, Richmond and San Francisco districts.

Commercial real estate markets continue to improve in most districts. Declining office vacancy rates and rising rental rates are reported in the Atlanta, Dallas, New York, Philadelphia and Richmond districts. New nonresidential construction is reported in the Atlanta, Dallas, Minneapolis,

Richmond and San Francisco districts. Contacts in the Chicago, Cleveland and St. Louis districts also describe their commercial real estate markets as strong.

Banking and Finance

Loan demand conditions are decidedly mixed across districts, although more districts report declining or steady loan demand than rising demand. The Dallas district reports little change in overall demand since its last report, and the San Francisco district reports healthy overall demand. Commercial and industrial (C & I) loan demand is reported to be strong in the Chicago district and steady in the Atlanta, Cleveland and Philadelphia districts. The Kansas City, New York, Richmond and St. Louis districts report slight declines in C & I loan demand. A number of districts continue to report low margins and fierce competition among lenders for C & I loans; a contact in the Richmond district characterized margins as “ridiculously low.”

Consumer loan demand is reported to be increasing, but at a slower rate, in the Chicago district and mixed or flat in the Atlanta and Cleveland districts. The Philadelphia, Richmond and St. Louis districts report declines in consumer loan demand. There appears to be no consistent trend in consumer loan quality; the Cleveland and New York districts report rising delinquencies, while the Atlanta and San Francisco districts report improving consumer loan quality. Residential mortgage demand is mixed. The Atlanta, Philadelphia and Richmond districts report increases in residential mortgage demand, while the Kansas City, New York and St. Louis districts report decreases.

Agriculture and Natural Resources

Other than weather-related cattle deaths in the Minneapolis district, increased profit margins are the rule rather than the exception among livestock producers. For example, the Kansas City

district reports that bankers expect wider margins for cattle and hog producers because of lower feed costs. Increased cattle prices have also been noted in the Dallas and Richmond districts, buoying producers.

In the natural resources industries, the Dallas, Kansas City and Minneapolis districts report that their energy extraction industries are experiencing an uptick of economic activity; this has occurred despite modest drops in crude oil prices. The Dallas and Minneapolis districts also report higher lumber prices, which, in Minneapolis at least, have been passed on to builders.

Weather-related problems have and will likely continue to affect economic activity in many districts. Severe winter weather in the Minneapolis district has reportedly hampered weight gains in the cattle industry. The Minneapolis district also reports a potential for the worst flooding in several decades because of substantial snowpack. Flooding and wind-related damage stemming from severe winter storms in early March have also been reported in the St. Louis district.

FIRST DISTRICT - BOSTON

Business contacts in the First District are fairly upbeat at the beginning of 1997. Most retailers report solid, sustainable sales growth, although a few sectors are weak. Manufacturers are seeing revenue gains as well, with over half the contacts reporting sales 8 to 20 percent ahead of a year earlier. Input prices and selling prices are mostly flat. Residential real estate continues to do well in New England and assets under management continue to rise at investment management firms. Most contacts in all sectors say they face tight labor markets for some occupations, but they cite only moderate increases in general wage levels.

Retail

A plurality of retail contacts report sales growth of 3 to 5 percent, a few percentage points greater than expected. The building materials and home furnishings sectors are doing even better, with growth in the 10 to 20 percent range. On the downside, apparel, discount, and appliance retailers report sales 3 to 8 percent below year-earlier levels. Inventories are generally in line with sales. With the exception of stores selling building materials and home furnishings, which expect sales to grow 15 percent, and discount and appliance retailers, who see ongoing consolidation contributing to continued losses, First District retail contacts expect moderate, sustainable growth to continue through 1997.

Retail employment is reported to be fairly level, and most retailers are expanding capital moderately. The exception is building materials and furnishings stores, which are expanding their work forces and making major capital investments. All contacts report rising employee turnover and increased difficulty replacing workers. Wages are said to be rising about 4 percent.

Respondents report that they are holding their prices steady, largely because competitive pressures constrain their ability to raise them. Only the discount retail sector engaged in significant price cutting during the last quarter (primarily to move product in the Christmas season). Profit margins are holding; retailers say they are operating more efficiently in order to offset rising wage costs.

Manufacturing

Most First District manufacturing contacts report that recent sales are above the levels of a year earlier, with just over one-half indicating growth as high as 8 to 20 percent. Strong gains are reported by makers of automotive, general industrial, and computer equipment, as well as furniture. A couple of these contacts expect to ramp up production in coming months to replenish stocks; another may have to turn down work because of capacity constraints. Manufacturers note some signs of turnaround in commercial aircraft and semiconductor markets. Medical sales are reportedly mixed, while markets for textiles and paper remain quite flat.

Most contacts report that, overall, materials costs are flat or down somewhat. Costs for some metals and furniture-grade lumber are rising, however. Selling prices also remain largely flat, except for small to moderate increases for fabricated metals, industrial equipment, and paper products.

Only one-quarter of the respondents have made substantial net new hires over the past year; the remainder report very little change in head counts. Most contacts anticipate only moderate increases in their work forces in coming months, while describing capital expenditures as heavy or rising. About one-half report delays in filling positions in information systems, engineering, technical sales, or finance. Wages and salaries are mostly rising in the range of 2 to 4 percent but considerably faster for some computer-related specialists; manufacturers generally do not view these increases as inflationary.

Manufacturers expect current business trends to continue for the remainder of 1997, although several express concern that the strong dollar could damp exports, and a couple mention upcoming labor negotiations as a potential challenge.

Temporary Employment Firms

Personnel supply contacts in the First District report 8 to 10 percent growth in revenues over the year ending in December 1996, with each quarter's growth rate falling short of the previous quarter's. The slowdown stems from worker shortages, as demand for qualified temporary labor continues to outpace supply across all industries and occupations. Nonetheless, respondents estimate their New England revenue

growth to be several percentage points higher than nationwide averages. Most contacts have seen improved overall performance in February 1997, and they expect revenues to expand at double-digit rates for the rest of the year. These 1997 growth forecasts are higher than 1996 actuals, but lower than both 1995 actuals and advance projections for 1996.

Respondents are feeling both wage and price pressures. Wages are rising at an 8 to 10 percent annual rate. Yet, as temporary services firms attempt to pass these increases on to their client firms, they face more aggressive price negotiations.

Residential Real Estate

The residential real estate market in New England continues to do well. While sales have increased in some areas and remained unchanged in others, most contacts report more inquiries and other signs of increased future activity. Mild winter conditions have contributed to the gains.

Massachusetts is doing particularly well, with 1996 showing the highest-ever annual increase in residential sales. Despite this record increase in sales volume, house prices continue to increase at a slower pace than during the 1987-88 real estate boom. Within Massachusetts, areas inside Route 495 are doing best, while the Springfield area is weakest. Other states are also doing well. Southern Connecticut and southern New Hampshire are reported to be very strong, and Maine and Vermont are both starting to pick up.

Nonbank Financial Services

Investment management firms report that in the fourth quarter of 1996, assets under management increased substantially over the previous quarter. However, assets were lower in December of 1996 than in November of 1996. Sales were reported to be highest in stock funds, particularly growth funds and growth and income funds. Most respondents increased employment in the fourth quarter and plan further employment increases in 1997. Contacts report hiring difficulties and wage pressures in the markets for computer programmers and equity analysts.

SECOND DISTRICT--NEW YORK

The Second District economy continued to improve since the last report, while price pressures remained subdued. Major retailers report that sales were ahead of plan in January and February, helped by mild weather and a week-long sales tax abatement in New York. Manhattan's commercial real estate market continued to tighten in January, with office vacancy rates declining and asking rents beginning to inch up. The market for both new and existing single-family homes has reportedly improved in early 1997, while activity in the multi-family segment remained steady at a fairly strong level. Consumer confidence rose sharply, to a cyclical high, in February. Regional purchasing managers' reports were mixed but, on balance, upbeat in the first two months of 1997. Finally, local banks report that overall loan demand has been steady, while delinquency rates on consumer loans continued to edge up.

Consumer Spending

Most major retailers in the region report that sales were above plan in January and February, with same-store gains ranging from 2 percent to the low double digits. Some attributed the strength to unseasonably mild weather—in contrast with last year—as well as New York's "tax-free week" (Jan. 18-25) when state and most local sales taxes were waived on most apparel. This tax waiver reportedly boosted January sales in New York State, especially in New York City. Moreover, New Jersey retailers, many of whom ran concurrent promotions and discounts, generally reported that sales were on plan.

Premium apparel continued to be the strongest category, followed by accessories and cosmetics. Sales of consumer durables were generally weak—most contacts report that home goods and electronics continued to lag, but one contact noted a pickup in furniture sales, while another cited strong sales of floor coverings. One large discounter noted that customer traffic was normal, but that average purchases were noticeably stronger. Two contacts noted particular strength in new (as opposed to clearance-sale) merchandise. Most retailers report that inventories are in "great shape"; one contact

mentioned that stocks are a bit high but “cleaner” (more salable) than in 1996.

Retail selling prices remain steady. Although a number of contacts report that competition is less aggressive than a year ago, retailers feel they have little if any ability to raise prices. However, the gradual shift in product mix toward more upscale merchandise has helped to boost retail margins.

Construction & Real Estate

Manhattan’s office markets continued to tighten in early 1997. The office availability rate for Downtown fell from 23.1 percent at year end to 22.4 percent at the end of January; in Midtown, it edged down from 13.4 percent to 13.2 percent; both are at new cyclical lows. Moreover, while asking rents remain flat Downtown, they have begun to creep up in the tighter Midtown market. Compared to a year earlier, rents were up 3.6 percent in January, versus a 1.9 percent rise for all of 1996.

Residential real estate markets have been steady to stronger in early 1997. Permits to build New York City apartments, which rose sharply in 1996, remained high in January, suggesting brisk construction activity in 1997. This, along with a wave of commercial-to-residential conversions, may be alleviating the shortage of multi-family units somewhat—according to a large New York City real estate broker, prices of prime Manhattan co-ops and condos have been essentially flat since last summer, and were lower in December and January than a year earlier.

The single-family market appears to be gaining momentum. Sales of existing homes across New York were up 5.7 percent from a year ago in January, with average prices up 5 percent. (Apparently, the January 1996 sales pace was little affected by last year’s blizzard.) In New Jersey, both realtors and builders describe the housing market in January and February as stronger than in early 1996; in absolute levels, existing home sales are reported to be fairly high, but new home sales are still quite low.

Other Business Activity

Regional purchasing managers reports were mixed in January and February. Buffalo-area

manufacturers report that growth in new orders and employment accelerated sharply in February, after dipping moderately in January, while production activity accelerated in both months. However, New York City purchasing managers report that the pace of business activity moderated in both January and February. Prices were reported to be essentially flat in both the New York City and Buffalo areas.

Consumer confidence surged to a six and a half year high in February, though it was still well below the national average. The impact of AT&T's recently announced reorganization plans remains to be seen. Tourism reportedly remained strong in early 1997, with first-quarter hotel occupancy rates projected to be up nearly three points from a year earlier; room rates continued to rise in early 1997, though the pace has slowed from the 10-12 percent registered in 1996.

Financial Developments

According to a survey of senior loan officers at small and medium sized banks in the District, demand for most categories of loans was substantially unchanged during the past two months. However, there was some slowing of demand in the commercial and industrial sector and continued weakness in the residential mortgage segment. Loan refinancings were down, on balance, with 26 percent of banks reporting a decline and just 11 percent reporting an increase. On the supply side, most lenders reported no change in their willingness to lend or in their credit standards.

Interest rates on most categories of loans were unchanged. The exception was residential mortgages, with 34 percent of banks surveyed reporting lower rates and only 6 percent indicating higher rates. Average deposit rates rose, with 32 percent of respondents reporting higher rates and only 11 percent indicating declines. Delinquency rates on consumer loans continued to edge up—they were higher at 30 percent of banks and lower at 20 percent; however, delinquency rates on nonresidential mortgages were lower than in the prior survey.

THIRD DISTRICT - PHILADELPHIA

Reports received from Third District business contacts in February were mixed but, on balance, indicated some slight improvement in economic activity. Manufacturers posted gains in orders and shipments and reduced inventories. Department stores and discounters boosted sales in February, compared with the previous month and a year ago, through widespread price reductions, but small retailers generally did not experience any increases. Most auto dealers reported steady rates of sales during the month. Bank lending appeared to ease a bit as business loan volume remained nearly steady and a decline in consumer credit more than outweighed an increase in residential mortgage lending. Real estate markets have shown some improvement. Demand for office space has been reducing vacancy rates and giving some upward impetus to rents, according to property managers in the region. Residential real estate agents noted a recent pickup in sales of both new and existing homes, but they said price appreciation has been very slight. Home builders also noted increased demand but said buyers are cautious about prices.

MANUFACTURING

Manufacturers in nearly all the Third District's major industrial sectors reported improved business in February. New orders increased at more than a third of the plants polled. The strongest gains were noted among producers of metals and metal products and chemicals; in contrast, apparel and furniture makers indicated a drop in demand during the month. Overall, area manufacturers stepped up shipments and reduced inventories.

Employment at Third District plants has been steady, but the number of companies that

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plan to add workers has risen recently. Around four in ten of the firms that commented on employment plans said they intended to add workers by the middle of the year, while only one in ten planned to reduce employment.

Industrial prices in the region have been mainly steady. Around three-fourths of the manufacturers reporting on prices indicated that both input costs and output prices have not changed since January. While there were slightly more reports of rising than falling prices, manufacturers continued to note that their ability to set prices for their products was countered by foreign competition. Suppliers to the automotive industry also noted continuing pressure from their customers to limit or reduce prices.

RETAIL

Retailers in the region gave mixed reports for February. Department stores and large discount chains indicated sales were strong but price cutting was pervasive. According to store executives, aggressive marketing applied to spring goods across the board and was not a response to inventory levels, which were generally described as lean. In contrast to chain stores, small specialty retailers said their sales were merely even with or slightly below year-ago levels, in dollar terms.

Comments from retailers suggested that consumer confidence is relatively buoyant, and the early discounting of spring merchandise is primarily a competitive tactic rather than a response to slow sales. Few retailers seemed concerned that the early push for spring sales would result in lower than usual sales later in the season, but some did say that price-cutting might limit profitability in the current quarter.

Most of the auto dealers contacted for this report said sales ran at a level pace during

February, although a few said sales of some popular sport sedans increased. Inventories were generally described as ample but not high.

FINANCE

Total loan volume outstanding at large Third District banks eased a bit in February. Gains in residential mortgage lending were being more than offset by declines in consumer lending. Bankers generally indicated that the drop reflected a seasonal paydown in credit card balances; however, some bankers believe that when net growth in borrowing resumes it might be slower than in the past few years because of the implementation of more restrictive credit standards on both new and existing accounts. Commercial loan volumes have fluctuated since the beginning of the year but have shown little overall change. Bankers interviewed in February foresee just slight growth in the months ahead, mainly from local middle market companies. In general, bankers expect commercial lending to just track the region's economy, which they anticipate will grow slowly.

REAL ESTATE AND CONSTRUCTION

Commercial real estate agents in the region said markets were improving as 1997 began. Office vacancy rates were estimated to range from 9 to 16 percent in suburban office markets, and they were falling while rental rates were moving up. In the Philadelphia central business district, the vacancy rate has not shown much improvement, although rents were firming. In both the city and suburbs, demand for Class A space was much stronger than demand for lower quality space. In a few tight suburban markets, Class A rents were said to have risen by around \$1 per square foot in the past three months and, at \$20 per square foot, just exceeded rates for similar space in the Philadelphia central business district. Demand for industrial space remained

strong throughout the region, although construction has been keeping pace with new demand, leaving vacancy rates and rents nearly steady.

Residential real estate agents and home builders also reported some signs of increased activity in February. Realtors said sales of both new and existing homes were picking up faster than they had anticipated. They cited a variety of explanatory factors: improved consumer confidence, relatively low and steady mortgage interest rates in the first two months of the year, and mild weather. Builders generally, though not unanimously, said they were signing a growing number of contracts for new homes in a variety of price ranges. Realtors noted that price appreciation for existing homes has been very slight, and builders indicated that competition among contractors and price resistance on the part of buyers were limiting their ability to raise prices.

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FOURTH DISTRICT - CLEVELAND

General Business Conditions

Business conditions remain good overall, although little net growth has occurred since the last District report.

Unemployment is holding steady at a low level in most areas, and reports of labor shortages persist, especially in central and southwestern Ohio and northern Kentucky. Indeed, unemployment in central Ohio fell to a 27-year low at the end of 1996. In the Dayton area, labor shortages have reportedly pushed the pay for unskilled workers one dollar or more above the new federally mandated minimum. In southwestern Pennsylvania, an area that has lagged the District over much of the current business expansion, the unemployment rate has recently dipped about 1/2 percentage point below the national average. A spurt in new business incorporations last year is reportedly a contributing factor in the area's recent economic rebound. A small rise in joblessness among construction workers earlier this year appears to have improved substantially with the relatively warm temperatures of the past month.

According to District employment agencies, hiring of temporary workers increased in the beginning of 1997 at a greater pace than a year ago. Some occupation mismatch was noted. For example, while workers with office computer skills were plentiful, low-skilled workers for data entry, accounting, and receptionist positions were scarce. One contact indicated difficulties finding machinists and welders, perhaps due to a reduction in training programs. Most agencies report that persistent labor

shortfalls have made corporate clients more agreeable to higher pay scales. Indeed, the rate of wage growth has been steadily increasing over the past year.

District real estate markets remain strong after a very good performance in 1996. One real estate professional characterized the housing market in southwestern Ohio and northern Kentucky as "extraordinary." In the commercial real estate area, the availability of office space in central Ohio is well below the national average, and vacant industrial space in Cincinnati is virtually nonexistent.

Manufacturing

Industrial activity is holding steady, and most respondents describe it as strong. Employment, production, and orders are all similar to those noted in the last District report. Steel orders and production have been good, although imports have increased. Capital goods producers indicate continued strength in new orders from domestic and foreign sources. Even heavy truck manufacturing, which retreated in 1996, has begun the year with a solid rise from the fourth quarter of last year. The dollar's recent runup in foreign exchange markets has had a negligible impact on foreign orders.

Price reports from industry continue to show little overall increase, with improved productivity accounting for any profit gains. Two sources noted that manufacturing wage growth had stepped above the 3 percent level, although these expenditures have also been matched by higher productivity.

Retailing

District retailers report mixed results for January and February, but give no indications that retail conditions have changed significantly since the previous District report. Spending activity during the two February holidays was thought to be about average. However, expectations for the first quarter as a whole are positive, and retailers are expecting sales to exceed last year's. Household supplies and better apparel items are considered to be selling particularly well, while electronics, furniture, sporting goods, and general apparel are not. Retailers indicate that prices are stable and that inventories are in good to excellent condition.

Auto Dealers

District auto sales slowed in February after a strong performance in January. Nonetheless, dealers remain optimistic about spring sales prospects and report that showroom traffic and general consumer interest have been strong. A few dealers stated that instances of insufficient equity and bad credit have increased. Leasing growth appears to have leveled off. While most dealers reported inventories slightly above desired levels, others noted limited supplies of specific models that were selling unusually well.

It is too early to gauge the full impact of a work stoppage at a major automobile supplier which temporarily idled 3,000 workers at a District auto assembly plant. However, area auto dealers expressed some concern about the shortage of a popular model that was caused by the strike.

Banking and Finance

Lending activity in the District was mixed by category and region during the first two months of the year. Commercial loan demand across the District ranged from good to disappointing. Of the banks reporting lower-than-expected commercial lending, one noted that a strong economy has allowed some firms to finance borrowing needs internally. Consumer borrowing trends have been flat throughout the District, with any growth attributed to seasonal demand.

Competition for borrowers is still sharp, although most respondents indicated that the spread between borrowing and lending rates has stabilized. Credit unions are emerging as a competitor for many community banks, particularly with regard to auto loans.

Credit standards this year are holding steady in most areas and have tightened for credit cards. Commercial loan quality is seen as very good, but consumer credit quality has deteriorated slightly due to heavier debt loads. Most District bankers feel that they have seen the worst of the recent rise in loan delinquencies. However, several respondents indicated that bankruptcies continue to increase. Despite competitive pressures and a rise in delinquencies, major District banks reported strong profits in 1996.

FIFTH DISTRICT-RICHMOND

Overview: Economic activity in the Fifth District continued to advance at a moderate pace in late January and February. Retailers said that after seasonal adjustment, sales increased at the fastest rate in several years. Service sector growth picked up sharply and tourism strengthened. Activity surged in both commercial and residential real estate. On a weaker note, District manufacturing output slipped somewhat and the volume of cargo moving through ports declined. In the financial sector, demand for consumer and commercial loans weakened slightly but mortgage demand strengthened. Employers continued to report difficulty filling vacant positions and indicated that wage pressures became more pronounced. Price pressures continued in most sectors although retail price increases moderated.

Retail Trade: District retailers reported that their seasonally-adjusted January and February revenues grew strongly, particularly at restaurants, pharmacies, and building materials stores. Apparel sales were steady and auto sales decreased modestly. Other retail indicators such as employment, shopper traffic, and wage levels remained strong. Contacts noted that their prices rose somewhat more slowly in recent weeks. Retailers' outlook remained bright; they expected demand for their products to increase during the next six months.

Services: Service sector revenues grew more quickly since the last Beige Book report, especially in health services, wholesale trade, and business services. However, contacts indicated that revenue growth slowed in transportation, communications, and public utilities. Employment and wage growth was more pronounced in recent weeks. Wage pressures were stronger in wholesale trade and business services but slackened considerably in health services. Contacts reported that their prices rose in recent weeks and they expected demand for their services to increase over the next six months.

Manufacturing: Activity in the District's manufacturing sector declined modestly. Durable goods producers indicated that shipments fell somewhat during the past six weeks although new orders changed little. Employment declined slightly as manufacturers faced increased employee turnover and experienced greater difficulty locating qualified workers.

Contacts reported more widespread labor shortages, particularly in the textile and industrial equipment sectors. Several firms indicated that the productivity of their new hires was unusually low; one manufacturer in South Carolina said that his firm had to provide more training "for those [workers] that don't learn as fast." Prices for finished goods and raw materials grew at slightly faster rates than in December, but respondents expected these prices to ease during the next six months.

Tourism: Tourism strengthened in late January and February. Respondents indicated that unseasonably warm weather boosted activity in coastal areas. One hotelier from the Outer Banks noted that her resort was "booked to capacity" on weekends. Despite the mild weather, contacts from Fifth District ski resorts reported that the number of visitors was approaching last year's record level; however, many apparently came to tee off rather than to ski. A contact at one popular ski resort said that March bookings looked very strong.

Ports: Representatives at District ports indicated that both imports and exports were lower in January than in December, but remained above year-ago levels. Most port contacts continued to expect higher volumes during the next six months, with exports outpacing imports.

Temporary Employment: The demand for temporary workers increased further in recent weeks; one placement agent in West Virginia described demand as "running about twice normal." Labor markets remained tight and contacts noted that applicants with computer skills continued to be in short supply. Several respondents reported that firms were increasingly turning to temporary employment agencies to fill permanent positions.

Finance: In recent weeks commercial and consumer loan demand weakened somewhat while mortgage loan demand strengthened. Contacts said mortgage lending was "surprisingly strong for this time of year," and several reported renewed interest in refinancings. Competition for commercial loans remained strong; one banker noted that margins had become "ridiculously low." Respondents indicated that the quality of consumer loan applicants had deteriorated in recent weeks. A North Carolina contact reported that his bank tightened credit standards for unsecured and automobile loans.

Residential Real Estate: Residential real estate activity accelerated in late January and February, fueled primarily by unseasonably warm weather. In general, Fifth District

contacts reported a surge in customer traffic and moderate increases in housing starts, sales, and permits. A realtor in the Washington, D.C., area remarked that "the market is tremendously active," while another respondent there noted that "business is booming." A Charlotte, N.C., homebuilder said that despite his attempts to avert a backlog of orders by aggressively raising sales prices, his homes were still selling. Overall, contacts reported that wages, materials costs, and home prices had increased slightly.

Commercial Real Estate: Commercial real estate activity continued to escalate since our last report. The leasing of office, retail, and industrial space accelerated in all jurisdictions except Virginia, where it remained at a brisk pace. Vacancy rates continued to fall except in North Carolina, where they were pushed higher by an increase in new space coming to market. Respondents across the District reported increased new construction; one North Carolina contact remarked that there was "so much dirt [from construction vehicles] on the road it was impossible to keep a car clean." The market for prime office space remained tight, and several contacts reported shortages in their areas. Rents rose in most jurisdictions, and one District of Columbia contact noted that "concessions are drying up."

State Revenues: State revenues increased at a slower pace in recent weeks. General fund collections grew more slowly in all jurisdictions except the District of Columbia and Virginia. Virginia's increase primarily reflected large gains in withholding tax collections.

Agriculture: Agricultural analysts indicated that weather conditions had varied effects on District farming activity. While wet weather this winter had delayed field preparation in the District, drier weather in recent weeks allowed farmers to catch up on scheduled activities somewhat. In contrast, milder-than-normal weather and adequate hay supplies aided livestock producers. Rebounding cattle prices increased producers' optimism about future profitability; one respondent said that "the tide has turned."

SIXTH DISTRICT - ATLANTA

Overview: The Southeastern economy continues to expand moderately in mid-winter, according to most contacts. Merchants report satisfactory sales and inventory accumulations, but they are cautious regarding spring sales and anticipate only marginal increases from a year ago. Contacts report increasing manufacturing activity for most sectors, although weakness persists for some apparel and textile producers. Tourism and convention activity continues at high rates, and officials report strong spring bookings. Reports on single-family home sales remain mixed, while commercial real estate markets are improving, and new development is accelerating. Bankers note moderate loan demand with quality improvements reported throughout the District. Although low unemployment rates in parts of the District are making it difficult for some employers to find qualified workers, wage increases have been relatively stable, according to most contacts. A late January freeze damaged crops in Florida, but the citrus crop was mostly spared.

Consumer Spending: According to most District retailers, sales during January were up significantly, while up only slightly during the early part of February on a year-over-year basis. The majority of retailers reported that recent sales have met their expectations, and that inventories are on target. Apparel sales continued to be extremely strong; cosmetics and home-related product sales also made strong showings throughout most of the District. Looking forward to spring sales, most retailers remain cautious, anticipating only slight increases over last year.

Construction: According to real estate contacts, single-family home sales were uneven in the District on a year-over-year basis in January and early February. Construction was generally flat. A majority of real estate contacts report that inventories of unsold homes are adequate for expected sales. A notable number of Realtors said that inventories were too low in their area of the region,

but few Realtors reported overbuilding. Realtors expect an increase in first and second quarter homes sales compared with a year ago, while builders anticipate home building will remain close to year-ago levels.

Contacts generally report that commercial real estate markets continue to improve. Declining vacancy rates and higher rental rates are propelling new industrial, office, and retail development in much of the District. Although most commercial projects are build-to-suit, a growing number of speculative projects are underway and more are anticipated this year. Overall, the multifamily sector remains healthy.

Manufacturing: Manufacturing appears varied but generally positive at this time, according to factory contacts. Automotive suppliers are expanding and their exports are increasing, resulting in overtime for employees. The lumber industry is picking up in parts of the District, and orders are increasing for machinery producers and food processors. Job rolls are expanding in Louisiana's energy extraction industries where suppliers say foreign sales have been especially strong. Shipbuilders in Mississippi report new contracts, and development of industrial projects continues at a rapid pace in northern Tennessee. Less positively, paper company contacts report no significant diminution of an extended wood pulp glut. Further closings of textile and apparel plants in response to foreign competition continue to be reported for parts of the region.

Tourism and Business Travel: The tourism and convention sector posts mostly favorable reports. Reservation trends are strong for south Florida resorts, hotels, and motels, with advance bookings up from a year ago. Tourism is also off to a good start in central Florida this year, with increasing airline passenger growth and packed theme parks. Convention activity is picking up in parts of the region; Huntsville recently hosted the largest convention in its history, and the

Supershow sports show in Atlanta attracted about 110,000 visitors. Less positively, gaming revenues for some Mississippi casinos are down slightly from a year ago as a result of new capacity coming online. The Super Bowl was a success in New Orleans, filling hotels to capacity; in contrast, preliminary reports suggest that Mardi Gras didn't attract as many visitors as a year ago.

Financial: Most banking contacts continue to report a moderate level of overall loan demand. Consumer loan demand varied across the region, while commercial lending remained flat in the last few weeks. Mortgage demand is accelerating slightly over January's levels but is flat compared with last year. Loan quality continues to improve across the District.

Wages and Prices: Contacts report that current wage increases appear to be moderate. However, reports of worker shortages for specific industries continue. In Louisiana, contacts note shortages of crews needed to work on offshore drilling rigs. Upper management and information systems personnel remain in high demand in parts of the region, although the overall paucity of well-qualified candidates has reportedly eased somewhat compared with several months ago. Some firms cite low unemployment rates as making it difficult to expand their operations. Contacts also note higher current prices for materials and finished goods; however, they look for price stability over the longer term.

Agriculture: The late January freeze severely damaged some crops in Florida. Hardest hit was Dade County where it is estimated that losses to the winter vegetable and tropical fruit crops could amount to \$93 million. Total losses across the state could reach \$250 million. The citrus crop was not as adversely affected by the freeze.

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SEVENTH DISTRICT-CHICAGO

Summary. The Seventh District economy continued to expand at a modest rate in January and February, though it lost some momentum from late last year. Growth in consumer spending was in line with national averages, but below most retailers' expectations. Housing and construction activity slowed slightly more than the normal seasonal downturn. Manufacturing activity remained at robust levels, but reports of change in activity were mixed. Lenders continued to tighten credit standards for consumer loans while competition was forcing them to ease standards for business loans. Labor markets remained very tight and wage pressures continued to mount, although productivity gains were reportedly keeping pressure off prices.

Consumer spending. Retail sales in January and February were moderately above year-ago levels, but slightly below most retailers' expectations. Post-holiday sales did well in January but results were mixed in February. Many contacts felt that severe winter weather may have hampered sales in some areas. Apparel sales, both men's and women's, continued to outpace overall gains and home electronics sales reportedly rebounded from a somewhat soft holiday season. While promotional activities were used by some merchants to deal with excess stock, most felt that inventories were in line with sales expectations. One large retailer indicated that early spring sales were strong and cited new spring fashions, favorable weather, and customers being "in a buying mood" as contributing factors. However, another major department store chain described February sales in the Midwest as "lackluster" with home appliance sales notably weak. Overall, however, most retailers felt that post-holiday and early spring sales were doing well, with Midwest sales about in line with those of the nation.

Housing/construction. Overall construction activity fell off slightly more than is normal for January and February, but most contacts reported that markets remained strong. New home construction and sales were adversely affected by the relatively harsh winter weather through much of the District. Most builders experienced a greater-than-seasonal

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decrease in single-family home sales while noting that the decline was “nothing to worry about.” However, home builders in eastern Michigan expressed concern over a sharp drop in permits so far this year. Builders associations in two of the District’s largest metro areas reported that condo and loft renovation activity in the central cities remained very strong, with one stating that the residential construction market was “the best in the last 10-15 years.” Commercial construction activity was strong in the first part of the year, mainly in suburban areas. Cement dealers reported that demand remained high and most were anticipating this strength to carry over into the spring in practically every building category--infrastructure, residential, commercial and industrial.

Manufacturing. Manufacturing activity generally remained high in the District, though some signs of slowing were reported. Responses to purchasing managers’ surveys for January and February were mixed, with some suggesting a modest pickup in activity and others indicating a slowing pace of expansion, especially in western Michigan. An analyst for the steel industry noted that, while steel demand remained strong in January and February, its forward momentum appeared to be gone. A machinery equipment producer reported that orders for the first quarter were up from a year ago, but much less than expected given the relative strength in the economy. Most of this company’s growth in orders was accounted for by the aerospace industry. A maker of electrical components for industrial usage stated that the unexpected strength they experienced last quarter had subsided. An agricultural equipment manufacturer noted that, while demand remained strong, production increases were constrained by the company’s reluctance to add permanent workers. A major producer of home furnishings reported that demand was strong in January and February and showed no signs of softening. Several contacts in the heavy-duty truck industry noted continued improvement in truck orders. However, the industry is benefitting from a return to seasonal buying patterns that were absent last year when backlogs were already high.

Banking. Conditions in the banking industry seemed to be divided by customer segment in the early part of the year--with standards being tightened on the consumer side and eased on the business side. Most banks reported that consumer demand remained strong but year-over-year gains in lending were smaller than previous months as a result of

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tightening standards. One banker noted that approval rates on consumer loans had dropped from 50 percent late last year to 20 percent so far this year. One large bank noted a switch by consumers to home equity loans that seemed to be driven by debt consolidation. Growth in business loans was reported by most bankers to be greater than on the consumer side. While most contacts indicated that industrial loans were primarily driven by equipment purchases, one stated that high production volumes were pushing some manufacturers to seek working capital loans. However, a small bank noted a drop-off in merger and acquisition loans since the beginning of the year. While one small bank reported strong C&I loan demand, growth had slowed in recent months largely because their two largest customers had pulled back their borrowing. Several bankers attributed some of the slowdown in their business lending to the emergence of alternative sources of funds. Virtually every bank contacted indicated that fierce competition was causing margins to narrow and concessions to be given in order to make business loans.

Labor markets. The District's labor markets changed little since our last report, remaining very tight with total employment growth lagging that of the nation. Respondents to purchasing managers' surveys from around the District suggest that the slow decline in manufacturing employment continued through the first two months of 1997. Several contacts indicated that the tight labor markets may be restraining the region's economic expansion. The average unemployment rate in the five District states ended the year at a seasonally adjusted 4.2 percent and there is no evidence suggesting any significant slackening in the labor markets in January or February. Shortages persisted in the technical fields (engineering and information technology) and one contact reported that building contractors in Michigan had resorted to recruiting at competitors' construction sites. Several contacts indicated that the upward pressure on wages noted in our last report had persisted. While wage pressures were reported to be broad-based across occupations, they were most severe at the upper end of the wage scale. One contact at a national staffing firm argued that any wage gains were being offset by increased productivity. Moreover, there were no reports of any discernible movement in prices as a result of labor cost increases.

EIGHTH DISTRICT - ST. LOUIS

Summary

The District economy continues to operate at a high level. Contacts report little or no change in the level of economic activity since the last report and continue to be optimistic about the near term. Labor markets remain tight in much of the District. A few contacts noted some slowing of sales at the beginning of the year, but are now seeing renewed growth. Tornadoes and severe flooding ravaged much of Arkansas and parts of Kentucky; effects on economic activity are still unknown. Residential construction in 1996 was stronger than a year earlier in most areas, despite the usual slowing at the end of the year. Commercial construction remains strong. Loans outstanding at large District banks have declined slightly since the start of the year. Surveys of District employers indicate that prospects for employment gains, although mixed, are expected to be less favorable in the second quarter of 1997 compared with the same period in 1996. State sales and income tax receipts for the last three months of 1996 showed strong growth compared with the last three months of 1995.

Manufacturing and Other Business Activity

Overall, District contacts report little change in sales and employment levels since the last report and remain optimistic about their near-term prospects. Contacts are concerned that continued tight labor markets will hamper their ability to hire new employees. Construction workers are very scarce, especially in southern parts of the District.

Many contacts report stable sales levels overall since the beginning of the year, although some experienced a slight slowing early on that appears to be reversing itself. For example, a contact in the heating and cooling industry reports that orders have recently slowed somewhat, but the industry is currently building inventory for the upcoming cooling season, its strongest season.

A firm that manufactures oil reclamation equipment is seeing orders delayed because of bottlenecks and postponements by its customers, many of whom are overseas. Several contacts, particularly from the poultry processing industry, report temporary production delays, as ice and extremely cold temperatures earlier this winter prevented employees and deliveries from reaching plants. The furniture industry reports strong sales, especially for wood furniture. The District's apparel industry, however, continues to shrink, as additional shirt and shoe makers move their production to Mexico and southeast Asia.

Storm Damage

Many tornadoes struck Arkansas, leaving much devastation in their wake, and severe rains flooded parts of western Tennessee and northern and western Kentucky, including the Louisville area. Damage estimates and the impact on short-term economic activity are not yet available.

Real Estate and Construction

Residential real estate markets showed their usual slowing in December. Only two of the District's 12 metropolitan areas had increases in the number of permits issued in December. Overall, though, 1996 was a good year in most markets, with eight metro areas experiencing more building than the year before. In many areas, real estate agents report record levels of sales for 1996. Commercial construction continues to be strong around the District. One banker noted that applications for commercial real estate loans were up substantially.

Banking and Finance

Total loans outstanding at six large District banks have declined 1.2 percent since the start of the year, after increasing 0.4 percent over the same period last year. All major categories show declines, with consumer loans dropping the most, 0.8 percent. Commercial and industrial loans have declined 0.2 percent, after rising 2.1 percent during the same period a year ago. Real estate loans have dropped by 0.5 percent, following a 1.2 percent increase a year ago.

Employment Outlook

Compared with the same period a year earlier, Manpower's second-quarter employment outlook survey depicts a mixed bag for major Eighth District cities. Employers in Little Rock were the most upbeat, with nearly half of surveyed firms planning to add to their payrolls, and none anticipating reductions. Prospects were somewhat less ebullient in Memphis, as the same percentage of firms plan to increase hiring this year compared with last; however, those planning workforce reductions have dropped modestly. The outlook was decidedly less upbeat in Louisville and St. Louis, with a far lower percentage of Louisville firms planning workforce additions, while a somewhat greater share of St. Louis firms are planning reductions compared with a year earlier. In general, employment prospects appear more favorable for those in nonmanufacturing than manufacturing industries.

A separate survey of District small businesses confirms this cautious outlook: Slightly more than 20 percent of firms plan to increase their payrolls in the second quarter, which is modestly smaller than the nearly 25 percent that reported they would last year. For the most part, employment prospects at retailers are more favorable than they were last year at this time, while those in the manufacturing and construction sectors are more uncertain.

State and Local Finances

State sales and income tax receipts showed fairly robust growth over the last three months of 1996 compared with a year earlier. Nominal District sales tax receipts (a seven-state total) over the last three months of 1996 were running a little more than 7 percent above the last three months of 1995, with receipts from Illinois, Indiana and Tennessee exhibiting the largest increases. District income tax receipts, on the other hand, showed slightly less growth, increasing by a little less than 7 percent over the last three months of 1996 vs. a year earlier.

NINTH DISTRICT--MINNEAPOLIS

Despite record snowfalls and severe cold, the pace of the Ninth District economy apparently is quickening. Construction and oil drilling are equal to or ahead of year-earlier levels.

Manufacturers generally report continued good business, if anything stronger than at the close of 1996. Retail sales of general merchandise and vehicles reportedly picked up in January and February after a subdued holiday season. Tourism reportedly has improved somewhat in recent weeks. Labor markets remain very tight, with reports of substantial pay increases for some computer and engineering specialists. But there are few reports of higher prices for goods or for inputs other than natural gas and lumber.

On the down side, the severe winter has been costly to agriculture. Output and employment at gold mines and oriented-strand board plants may be reduced due to declining product prices and large inventories.

General business and economic conditions

Confirming anecdotal reports of a strong economy, the state of Minnesota projects a \$2.3 billion surplus for the upcoming fiscal biennium due to extremely strong tax revenues and low welfare and unemployment outlays. This is up from a preliminary \$1.4 billion projection made only weeks earlier. Most other district states also are in good fiscal positions.

Construction and real estate

“Housing market explodes,” headlined a special report in a west-central Wisconsin newspaper which predicted “activity expected to remain strong.” In Sioux Falls, S.D., the value of January building permits was nearly twice that of a year earlier, and builders expect 1997 to be even better than 1996. For the Minneapolis-St. Paul metropolitan area, new home permits for January were up slightly from a year earlier, a time when building already was at a fast pace. News reports on higher lumber prices noted that this factor was pushing up the cost of new homes, but that higher prices were doing little to dampen new construction orders.

Construction of two major office buildings was announced recently in Minneapolis. Three large employers leased office space in downtown St. Paul, significantly lowering vacancy rates.

Natural resource industries

The North Dakota oil boom, which continues at an active pace in spite of a bitter winter, has extended to Montana, where the rig count is about twice that of a year ago. Iron mining is straining against the constraints of harsh weather to meet desired shipments. Lumber mills in

the western portion of the district are profitable as the result of higher lumber prices, but output continues below levels of a few years ago due to decreased sale of timber from federal land. Sources in the paper industry also report stronger prices and output after a slump in 1996.

On the negative side, some Montana gold mines are expected to slow output in 1997 due to low prices. And a major producer of oriented-strand board announced it will lay off 500 workers at three plants for at least two weeks in March because of growing inventories and falling prices. The phenomenon of sharply higher dimension-lumber prices coinciding with lower building board prices occurred because the latter product has not been subject to the same supply limitations as saw timber.

Manufacturing

“Business boom underway,” headlined a Houghton, Mich., newspaper’s description of the expansion of light manufacturing in its area. “Business has been extremely good,” reports the owner of a North Dakota aluminum extrusions producer. In a similar vein, Minnesota manufacturers of bolts and other fasteners, of air filtration equipment, and of industrial painting and lubrication equipment reportedly expect strong growth in 1997. In Butte, Mont., construction of a \$465 million silicon plant is well under way and should employ 165 production workers in mid-year. Overall, Ninth District manufacturing appears hale and hearty, with generally good sales and few price pressures on the input side. Inventories are described as normal, and no delays or bottlenecks in delivery of inputs are apparent. Securing skilled labor is the only problem commonly reported by manufacturers. A steel firm describes sales as “moderate, but stronger than three months ago.”

Agriculture

“You are continually tired, it just never lets up,” is how one South Dakota farmer describes the challenge of caring for livestock in the most severe winter in decades. Many cattle have died, including at least 40,000 head in South Dakota, or 2 percent of that state’s beef herd. Many farm buildings have collapsed due to abnormal snow loads. In Minnesota, over 5,000 farm buildings have been damaged or destroyed, and the number is thought to be similar in the Dakotas. Most farmers have unusually high fuel expense for snow removal, and livestock weight gains and general condition are poor. Hay prices are well above normal levels in many areas. Looking ahead to warmer weather, federal hydrologists warn that the potential for flooding in many areas is the highest in decades.

Consumer spending

After a somewhat restrained holiday season, several retailers reported much stronger sales in January, but at very thin margins. One Montana mall reported January sales up 26 percent compared to the same period in 1996. This pattern of stronger January sales is confirmed by mall managers in other district states, although traditional Main Street retailers in western Minnesota and in North and South Dakota complain of disruption of sales by successive winter storms.

“Dealers have sold a ton of pickups,” reports one South Dakota source. Other industry spokespersons describe a pattern similar to general merchandise sales, that is general improvement in spite of episodic slow periods due to bad weather.

Tourism and recreation

“Things are looking good,” reports a northern Wisconsin tourism official, citing favorable snow conditions for snowmobiles and cross-country skiing. After a slow start, tourism and hospitality firms report some improvement in several areas. January tourist-related tax receipts were up 11 percent in western South Dakota compared to a year earlier. A Minnesota ski resort owner describes business as moderately good in spite of increasing nationwide competition in the sector and adverse demographic trends.

Employment, wages and prices

“It got crazy right after New Years,” reports the CEO of a software firm with operations in Wisconsin and Minnesota. “Other companies are paying up to \$25,000 additional per year to pirate programmers away from my company.” This phenomenon, confirmed by other sources in the software industry, is attributed in part to mushrooming attention to the “Year 2000” problem in much existing software. “It’s becoming a feeding frenzy,” says another source. While no other sectors report the 20 percent to 50 percent increases offered to skilled programming specialists, the market for technical specialists remains very tight. A Minnesota electronic device and instrument firm reportedly is offering \$5,000 signing bonuses plus pay approaching \$40,000 to engineering majors who will receive their B.S. degrees in June.

Despite tight labor markets, there are few reports of increasing prices at producer or consumer levels. One exception is natural gas, cited by many industrial firms such as foundries and glass factories that use this resource for process heat.

TENTH DISTRICT - KANSAS CITY

Overview. The district economy continued to grow moderately last month. Retail sales increased, manufacturing activity remained strong, and energy activity improved. Construction activity generally held steady. In the farm economy, the winter wheat crop remained in good condition, and an improved outlook for the cattle industry slowed liquidation of district cattle herds. Labor markets remained tight in much of the district, although there were fewer reports of wage increases than in previous months. Prices were generally stable at the retail level and for materials used in manufacturing and construction.

Retail sales. Retailers report sales increased last month and were higher than a year ago. Sales of apparel were strong, especially men's clothing. Total sales are expected to increase moderately in the coming months. Retailers have been trimming their inventories but report they are generally satisfied with current stocks and plan no major changes in the next several months. Automobile dealers report sales were up slightly last month and expect sales to increase somewhat in coming months. Sales of light trucks and sport utility vehicles remained particularly strong. Dealers have been holding inventories steady but expect to expand stocks somewhat in the next several months to meet increased sales.

Manufacturing. Manufacturers continued to operate at moderately high levels of capacity last month. Manufacturing materials were generally available, with lead times holding steady. Manufacturers have been trimming their inventories, and some say they plan further reductions because stocks exceed desired levels. A quarterly survey of district manufacturers indicated that production, shipments, and new orders all increased modestly from December to January.

Housing. Builders report housing starts generally held steady last month and were unchanged from a year ago. Builders expect construction activity to improve somewhat in the coming months. Sales of new homes increased last month. Most building materials were readily available and delivery times were normal. Mortgage lenders say demand last month was unchanged.

Banking. Bankers report that loans decreased and deposits increased last month, reducing loan-deposit ratios somewhat. Commercial and industrial loans, home mortgage loans, and residential construction loans declined, while agricultural loans edged up. Increases in NOW accounts and money market deposit accounts contributed to the rise in deposits.

Respondent banks held their prime lending rates steady last month and expect to leave rates unchanged in the near term. Banks also held their consumer lending rates steady and plan no changes in the near future. Lending standards were unchanged at most banks.

Energy. District energy activity improved last month. Oil and gas prices fell somewhat but remained well above year-ago levels. The high prices helped boost the district rig count 10.2 percent in February to a level 27.5 percent higher than a year ago.

Agriculture. The district winter wheat crop remains in good condition. Growing conditions have been favorable recently, with much of the crop receiving either a protective cover of snow or beneficial rainfall. Wheat pasture is also reported to be in good condition. Cropland rents are increasing in much of the district as farmers anticipate that crop prices will remain well above breakeven levels. While most crop prices have moderated from the record levels set in 1996, they are still high by historical standards.

Bankers predict that district cattle and hog producers will enjoy a profitable year in 1997,

thanks to lower feed costs. The favorable outlook for the cattle industry may bring an early end to the liquidation phase of the cattle cycle. Bankers report that district ranchers appear to have stopped reducing their cattle herds, and some are making plans to expand.

Wages and prices. Labor markets remained tight last month in much of the district, although there was less evidence of wage pressures than in recent months. Some manufacturers report skilled workers were in short supply, and some retailers say qualified salespeople were hard to find. Fewer companies than in previous months, however, report they raised wages to attract or retain workers. Prices held steady at the retail level and for most manufacturing and construction materials. Retailers expect no major price changes in coming months.

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ELEVENTH DISTRICT--DALLAS

Eleventh District economic activity continued to expand at a modest pace in January and February. Price reports were mixed, with somewhat more downward pressure than reported in the last beige book. Manufacturing remained in a seasonal lull, although energy-related manufacturing was still strong. Demand for business services continues to increase, but most firms reported difficulty meeting demand because of a shortage of workers. Retailers reported "good sales," with less discounting than at this time last year. The financial services industry reported little change in loan demand. Construction activity increased modestly. Oil service companies continued to report extremely strong and growing demand for their products, despite falling energy prices. Rain delayed agricultural operations but provided need moisture for stock ponds, spring crops and summer forages.

Prices. Price activity was mixed, although there were more falling prices reported than in the last beige book, most notably in the energy industry. After peaking at \$26 per barrel in early January, prices for light sweet crude slipped back to \$21-\$22 by late February. Crude prices were led by falling heating oil prices, which fell from over 70 cents per gallon in early January to under 60 cents by late February. Inventories rose steadily in recent weeks, even as an unusually large number of refineries shut down late in the season for semi-annual maintenance. Gasoline remains in tight supply on the Gulf Coast, and the late start in making gasoline for the summer still leaves some concern about supplies for the coming summer driving season. However, near-term gasoline futures and spot prices have dropped sharply in recent weeks, from over 70 cents to near 60 cents. Natural gas spot prices have also fallen, and inventories are running 19 percent ahead of last year. The paper industry also reported falling prices, where the prices for some products had dropped as much as 14 percent over the last 6 weeks. Electronics manufacturers said prices had stabilized, with the normal downward trend, and inventories

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were decreasing, but most respondents said inventories are “slightly too big” still. Producers of lumber and wood products expect prices to increase in 2 months. Service sector wages and fees have increased, although most contacts said price increases have not kept pace with rising costs. Escalating office rents concerned respondents in the Dallas area. Petrochemical producers have raised prices for many products, including polyethylene, polystyrene and PVC, boosted by low inventories, strong domestic demand and extremely strong demand from Europe and South America.

Manufacturing. Manufacturing activity remained in a seasonal lull, although energy-related manufacturing was still strong. Demand for brick, lumber, concrete and construction-related fabricated metals was down because rainy weather slowed construction activity, but contacts expect a bounce back will result in “a very strong spring”. The paper industry reported a downturn over the last 30 to 40 days, partly due to a drop in demand, but also because overbuilding created excess capacity. Inventory problems were reported at both the mill and customer levels. Contacts in the semiconductor and computer industry said demand was up over the last six weeks and the past year. Refinery margins remained weak as heating oil and gasoline prices fell faster than crude oil prices. Several refiners continue to look at mergers, restructuring and cuts in capital spending to reduce costs.

Business Services. Demand continues to increase for temporary workers, accounting, consulting and legal services. Contacts cited the high technology sector, commercial lending activity, corporate litigation and a growing economy as the primary sources of strength. However, most firms reported difficulty in meeting demand due to a shortage of workers. One contact said demand had outstripped supply for both consulting and accounting services. Contacts were optimistic about business conditions over the next several months.

Retail Sales. Retailers reported “good sales,” with less discounting than at this time last year. As one contact said: “I hear over and over again that the markdowns went very well.” Contacts

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reporting the best sales results also noted improvement in sales to Mexican customers. One contact said that sales to Mexican shoppers were showing a “pretty good resurgence,” including evidence of some wholesale buying, although sales were not back to the pre-peso devaluation levels. Inventories are reported to be in good shape. Auto sales were reported to be slower than expected.

Financial Services. Contacts reported little change in loan demand over the last six weeks. Outlooks remain optimistic for all loans types for the rest of the year.

Construction and Real Estate. Construction activity increased modestly. Contacts in several major Texas cities reported that hotel construction picked up strongly over the last six weeks. In addition, increasingly tight office markets across the state continued to boost office rents and plans for new office construction. Demand remained strong for industrial space, but some respondents continued to report that new supply was outstripping demand. The pace of single-family home construction has slowed, but some of the slowdown may be seasonal and/or due to extremely wet weather in February. Contacts are optimistic that 1997 will be a good year for residential construction, but most doubt they will match the high level of new home construction recorded in 1996.

Energy. Oil service companies continued to report extremely strong and growing demand for their products, despite falling energy prices, which had been anticipated. The normal seasonal dip in the rig count all but disappeared in early 1997, with the rig count quickly returning to year-end levels of drilling. Shortages of selected oil-field skills continue, and the industry continues to hire to meet current high levels of demand.

Agriculture. Rain delayed land preparations and planting operations but provided needed moisture for stock ponds, spring crops and summer forages. Livestock conditions remained good across the state and many auctions continued to report higher prices.

TWELFTH DISTRICT—SAN FRANCISCO

Summary

Reports from Beige Book contacts indicate a strong pace of economic growth in most 12th District states in the beginning of 1997, with Hawaii being the most notable exception. Retailers reported moderate gains in recent months, and service providers in the District noted an acceleration in growth above an already rapid trend. Manufacturing activity remained strong in much of the District, lifted by a booming aircraft industry and steady expansion in high-technology equipment manufacturing. Recent increases in residential and commercial real estate demand have fueled construction activity in the District. Respondents' generally positive views of the economy were tempered by many reports of tight labor markets and increasing wage pressures. High turnover rates, reflecting frequent "job-hopping," were noted by several contacts in a variety of industries.

Business Sentiment

District respondents expect continued strong performance in the national economy, with regional economic growth outpacing the national rate. Most respondents expect U.S. GDP growth to return to its long-run average pace, leaving the national unemployment rate near its current level. Although slightly more than one half of the respondents expect inflation to remain near its current rate, a growing proportion of respondents expect inflation to edge up in 1997. Nearly all respondents expect growth in their local economies to outpace growth in the national economy. Respondents are optimistic about the strength of business investment and foreign trade in their areas, as well as about consumer spending and housing starts.

Retail Trade and Services

Most District respondents reported moderate growth in retail sales through February. Retail sales reports were strongest in California and the Intermountain states, where healthy sales of both durable and nondurable goods were noted. In the Pacific Northwest, inclement winter weather tempered retail sales in January, particularly in Oregon, but sales reportedly strengthened in recent weeks. Stiff competition among retailers was credited with keeping prices down, despite lean inventories and growing wage bills.

Service industry respondents in most District states continued to report robust growth. In California, the expansion of demand for telecommunications services remained solid, although growth slowed slightly. Tourism-related restaurant sales, car rentals, and hotel occupancy were very strong throughout the District. Hotel occupancy rates remained particularly high in Utah and Nevada, despite increases in the supply of rooms. Respondents indicated that the continued strength of the tourism sector has tightened the market for hospitality workers, creating a climate of “job-hopping” and putting upward pressure on wages.

Manufacturing

Reports on District manufacturing activity were generally positive. In the Pacific Northwest, the aircraft and high-technology sectors continued to expand, fueling demand for skilled workers, and putting significant pressure on wages. Food processing plants in the Pacific Northwest noted a substantial pickup in the domestic and foreign demand for their products, making capacity constraints a binding factor in further growth. In California, growth in the electronics industry remained healthy, although recent deceleration was noted. Respondents from several District states reported difficulty in finding skilled employees for manufacturing jobs;

reports of labor market tightness were most pronounced in Seattle and the San Francisco Bay Area.

Agriculture and Resource-Related Industries

Agriculture conditions generally were favorable in the District. Ample moisture and fair weather conditions were noted throughout the District, benefiting both ranchers and farmers. Reports from California and Arizona indicate that grazing pastures are full and that heavy demand for grassland areas is driving up rents. Crop development in most District states is proceeding on schedule.

Real Estate and Construction

Residential real estate activity reportedly was strong in most District states. Demand for single family homes continued to grow in the Pacific Northwest, reportedly creating local shortages of materials and labor. In the Intermountain states, sales of middle-market housing slowed in recent months, but the demand for entry level homes remained strong relative to available supply. In California, the housing market continues to gain strength. Sales of new and existing homes grew in both the San Francisco Bay Area and Southern California in recent months, and home prices are appreciating in most areas.

Commercial construction activity also was strong in most parts of the District. In the Pacific Northwest and Intermountain states, respondents report that commercial office and warehouse space is hard to find and commercial and industrial construction is rising. In Southern California, respondents report that the volume of commercial construction activity, while modest, is higher than it has been in several years.

Financial Institutions

District financial institutions continued to report healthy loan demand and generally good credit conditions. Financing remains readily available for qualified businesses and stiff competition is encouraging lenders to offer more favorable financing terms. Reports regarding loan delinquency rates and new loan quality are more positive than in previous months. The ongoing consolidation in the banking industry has left many experienced financial-sector workers available for hire, minimizing wage pressures in this industry.