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Summary of Commentary on _____

Current Economic Conditions

by Federal Reserve District

January 1998

**SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICTS**

JANUARY 1998

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SUMMARY*

Federal Reserve Districts reported that as 1997 came to a close the pace of economic growth continued to be moderate. After a slow start in early December, retail sales gathered momentum in the days before Christmas and during the post-holiday weeks. Overall, retail sales for the holiday season were mainly at or slightly above expectations. Motor vehicle sales picked up at yearend due mainly to strong sales of sport utility vehicles, minivans, and light trucks. Manufacturing activity remained fairly strong, although some Districts reported signs of easing. Construction and real estate markets were strong at yearend, with tight markets for office and industrial space in several regions. Some Districts reported evidence of more speculative construction in response to increasing rental rates. Lending activity was brisk throughout the nation despite softer demand for consumer loans. Agriculture reports were generally favorable, although adverse weather has hurt livestock production in some Districts. The impact of Asian financial turmoil was felt in most Districts. Manufacturers and agricultural firms report weaker exports to Asia, and there was some evidence of increased competition from Asian products in U.S. markets. Despite lower prices, oil and natural gas drilling activity was strong last month.

Labor markets remained tight or very tight in all Districts. Reports of firms scaling back production or expansion plans due to labor shortages were more common. Some Districts reported increased wage pressures, particularly for retail workers and some skilled occupations.

* Prepared at the Federal Reserve Bank of Kansas City and based on information collected before January 12, 1998. 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.

According to business respondents, prices were generally flat due to intense competition and lower import prices.

Consumer Spending

Most Districts reported that retail sales were slow in early December but picked up strongly during the days before Christmas and during post-holiday sale events. With few exceptions, holiday sales met or slightly exceeded expectations. Retailers noted that sales of electronics, computers, appliances, and jewelry were particularly strong. Some merchants reported disappointing sales of winter-related items, such as snow-blowers and winter clothing, due to unseasonably warm weather in many parts of the country. Post-holiday inventories were at desired levels. The tourism industry posted strong holiday results, with hotels operating at record high occupancy rates in areas such as New York, Boston, Florida, and California. Ski resorts, however, reported problems due to lack of snow.

Automobile dealers enjoyed good overall results last month, although sales were mixed across vehicle categories. Sales of sport utility vehicles, minivans, and light trucks remained stronger than sales of passenger cars.

Manufacturing

Manufacturing activity remained fairly strong, although some Districts showed signs of easing. Boston and Philadelphia reported manufacturing activity improved last month, while New York and Dallas noted weaker performance for the sector. Richmond reported a sharp slowdown in activity. Strong demand, production, shipments, and new orders were reported for aircraft

parts, telecommunication and computer-related products, capital goods, and automobiles. In most Districts, the Asian financial turmoil started to have some impact on manufacturing activity. Some Districts reported weaker export demand for industrial equipment, building materials, aircraft parts, semiconductors, processed food, and some metals. There was also some evidence of increased Asian competition in the domestic market. Manufacturers in several regions expressed concern that the Asian turmoil and the overall strength of the dollar might hurt sales and profits in 1998.

Labor availability remained a major concern in most Districts. Manufacturers continued to report difficulties in hiring skilled technical workers, such as engineers. Some contacts in the St. Louis District could not meet demand because of a shortage of workers, and a major producer of high-tech equipment in the Chicago District had to cancel some projects because of the shortage of engineers.

Construction and Real Estate

Construction activity and real estate markets remained strong in most parts of the nation. The only two exceptions were Atlanta and Kansas City. New home sales in the Atlanta District were flat-to-down compared to last December, while construction activity was spotty. In the Kansas City District housing starts were down slightly last month.

Low and declining vacancy rates for retail, office, and other commercial space in urban areas began to put upward pressure on rental rates. Evidence of some speculative construction was cited by Boston, Atlanta, St. Louis, and Dallas as a response to persistently strong demand for commercial and industrial space.

The housing market remained strong in most regions. Unseasonably warm weather in many areas of the country boosted traffic and sales of new homes above their average December levels. Housing markets showed further signs of strength in New York and Dallas and a slight rebound in Chicago. In the Minneapolis District a fast construction pace became the norm.

Banking and Finance

Lending activity was brisk in most Districts, led by strong demand for commercial loans and mortgages. New York reported small to medium-sized banks faced softer demand for loans, especially for consumer loans and residential mortgages. Minneapolis reported that demand for bank loans was softening after a very strong 1997.

Most Districts reported that demand for mortgage refinancing was strong due to falling mortgage rates but that demand for consumer loans remained sluggish. New York, Cleveland, and Dallas noted that loan delinquency rates declined or stabilized at moderate levels.

Lenders in most Districts reported that strong competition was reducing the spread between borrowing and lending rates, particularly for quality borrowers. In contrast, contacts in Richmond indicated that pricing spreads had been maintained. In general, lending standards were unchanged in most of the Districts.

Agriculture, Energy, and Natural Resources

The agriculture reports were generally favorable, although performance was mixed across crops and livestock. Favorable crop conditions were reported by Richmond, Kansas City, Dallas, and Minneapolis. Winter wheat and small grain crops appeared to be in good shape. Crop

harvesting was near completion in the Richmond District, and contacts there suggested that yields of most crops might fall short of 1996 levels. Chicago noted that farm prices for many key Midwest commodities have declined recently, which may hurt farm earnings in 1998. Chicago, St. Louis, and San Francisco reported that some agricultural producers were concerned that Asian turmoil will lead to weaker farm exports in 1998.

In the livestock sector, Kansas City and Minneapolis reported favorable conditions, while Dallas reported that snow and cold temperatures hurt some livestock operations. San Francisco also reported herd losses due to unfavorable weather and grazing conditions, particularly in the mountain states. Chicago noted that a seasonal rise in domestic hog marketings and a bulge in hog imports from Canada contributed to a decline in U.S. hog prices.

Minneapolis, Kansas City, and Dallas reported strong drilling activity for oil and natural gas last month despite weak energy prices. Minneapolis noted that output for iron ore and most forest products may stabilize in 1998 after strong or moderate growth in the last two years. San Francisco reported that a number of western mines had shut down operations due to falling gold prices.

Labor Markets, Wages and Prices

All Districts reported that labor markets were tight or very tight last month. Although labor shortages appeared to be broad-based, some skilled workers were in especially short supply. Most areas noted problems in finding computer-related workers, construction skilled tradesmen, and technicians. Shipbuilders in New Orleans were looking to hire foreign welders, shipfitters, electricians, and others. A company in Nashville was forced to idle more

than 10 percent of its equipment due to labor shortages. In the Chicago District some projects were canceled due to a lack of labor, while in the St. Louis District some contacts were unable to meet production schedules due to labor problems. Some businesses in the Cleveland District increased their recruiting efforts, resulting in higher demand for human resources personnel.

Some Districts reported increased wage pressures, especially for some specific industries and skilled occupations. Boston and Richmond reported upward wage pressures in the retail sector. Boston also noted that some manufacturers began offering double-digit pay increases in categories such as engineering. San Francisco reported that wage and salary pressures remained high in financial institutions. Some employers in the Dallas District began offering higher compensation for skilled and semiskilled workers in the service sector and for skilled workers in construction, fabricated metals, bricks and lumber. Atlanta, Chicago, and Minneapolis reported that wage pressures were generally being held in check, with more significant wage pressures confined to specific skilled workers.

Most Districts suggested that employers continued to be creative in finding and recruiting additional labor. Some companies were subsidizing transportation for employees located far away from their work sites. Employers in several Districts adopted flexible work schedules and more generous benefit packages.

While reports of price changes for goods and services were mixed, prices overall remained generally flat. At the retail level, many Districts reported that most of the holiday sales occurred late in the season at large discount levels. Richmond reported that prices in the retail, service, and manufacturing sectors grew at a somewhat slower pace than in the last

report, except for soaring prices for starter homes in a specific area of North Carolina. Manufacturers in most areas reported stable prices for their inputs and final goods, due to intense competition and lower import prices. Minneapolis noted that manufacturers of intermediate goods continued to receive pressure from customers to lower prices. Tourism appeared to be an exception from the overall price picture, with Boston, New York, and Atlanta reporting higher rates for hotel rooms. Higher rental rates were also reported for commercial and industrial space in many urban areas.

FIRST DISTRICT - BOSTON

The First District economy is strong. For manufacturers and retailers, sales are generally up, employment is level or rising, and prices are largely stable. Commercial real estate markets are more robust in Greater Boston than elsewhere in New England.

Retail

Most retail contacts report that sales grew at a moderate to strong pace in the fourth quarter, matching expectations for the period. Sectors of strength are office supplies, tourism, appliances, and mail-order apparel. Weakness is reported in only one sector: men's leisure wear. In all sectors, inventories are at desired levels. Looking forward, retail contacts expect sales growth in the 4 to 7 percent range for 1998, about on par with recent trends.

Employment is said to be either increasing moderately or holding steady. Most contacts report that labor markets were tight during the holiday hiring period, with employers encountering difficulty in finding, attracting, and retaining employees. Permanent staff levels appear to be holding steady, with highly skilled computer programmers being the primary occupation with shortages. Among retailers reporting tight labor markets, half are offering wage premiums as one device to hire and retain help, although one contact said such premiums were ineffective. In general, wages are said to be increasing at a 3 to 5 percent annual rate, with selective premiums adding another 5 to 10 percent for specific individual employees.

Most respondents report that prices are holding steady. The exception is tourism, where excess demand for hotel rooms in Greater Boston has led to significant price increases. Materials costs are also said to be holding steady, except for paper products, for which prices are rising. Half the contacts say profit margins are either level or increasing slightly. The other half report slight declines in margins, suggesting that rising wage costs may be more than offsetting productivity improvements.

Most contacts have modest capital expansions planned for 1998. New England retailers are quite

optimistic, expecting growth to continue at a healthy pace during the next six months. None of the contacts express concern that sales will slow as a result of the Asian financial crisis.

Manufacturing

Almost all First District manufacturing contacts report that recent business is up from a year ago, with about half reporting double-digit gains in sales or orders. The trends are particularly strong for aircraft parts, biotech products, telecommunications and computer-related equipment, sporting goods, and small tools. The majority of automotive parts suppliers contacted indicate that business is very robust, with some citing rising backlogs. For others in this industry, however, sales are declining. In addition, equipment makers serving overseas markets indicate that currency translation has resulted in weaker revenues.

Contacts generally believe the U.S. economy remains in good shape, with several citing accelerating domestic demand for their products. Most exporters indicate that they have not yet felt a decline in sales volume as a result of the Asian crisis. However, they have downgraded their projections for sales to Asia and they expect to face stiffer competition from Asian firms in other markets.

Manufacturers indicate that most materials costs are flat to down. Costs rose a little at the beginning of 1998 for some grades of paper but held steady for others. Travel costs are said to be increasing. Selling prices are largely stable. Manufacturers have implemented small increases for selected paper products and for fabricated metal products that are in short supply.

Employment is holding steady at about three-quarters of the manufacturers contacted while increasing substantially at the remainder. Average pay is said to be rising at a rate of 3 to 6 percent. Manufacturers indicate that markets continue to be very tight for specialized technical and professional personnel, with double-digit pay increases in some categories such as engineering. A few report rising turnover or greater challenges in recruiting blue-collar workers, although most remain satisfied with availability.

Many manufacturers expect to make heavy capital investments this year, in order to expand capacity

or improve efficiency. Most of the remaining companies indicate a moderate need for plant and equipment. By exception, a large exporting firm is now scrutinizing capital expenditures more closely in anticipation of margin pressures.

Commercial Real Estate

Boston continues to lead the commercial real estate market in New England. All sectors of the Greater Boston market are strong. Vacancy rates are around 5 to 6 percent for office space and below 3 percent for retail space. During the past year, rental rates have reportedly increased 12.5 percent on average and about 30 percent for prime downtown and suburban office spaces. Small high-tech firms continue pushing up demand for suburban office space. For the first time since the 1980s, some speculative construction is being undertaken, although banks are still very cautious about lending money for this purpose.

Commercial real estate markets in the rest of New England are mixed. The areas adjacent to Greater Boston--southern New Hampshire and Rhode Island--are also strong, with inventory levels shrinking and prices increasing slightly. However, the market in downtown Providence has not changed, and the Greater Hartford area showed no improvement during the last quarter of 1997. Moreover, several major retailers around Hartford closed their doors, leading to an increase in retail vacancy rates and a drop in retail rental rates in the area.

Nonbank Financial Institutions

Respondents at insurance companies report increases in revenue in the range of 5 to 10 percent in the fourth quarter of 1997 compared to the fourth quarter of 1996. New sales at life insurance companies continue to be driven by variable products linked to the stock market. A few contacts mention increased downward pressure on premiums relative to claims for group health and commercial property/casualty insurance. Several insurers reduced their employment in 1997 while others intend to do so in 1998. Respondents note continued difficulties in finding information technology specialists but some indicate that wage pressures in this field were lower than could be expected.

SECOND DISTRICT--NEW YORK

Reports in recent weeks paint a generally positive picture of the Second District's economy. Retailers report that sales were mostly close to plan in December, as a late surge offset early-month weakness; retail selling prices and merchandise costs were flat to down slightly. The housing market showed further signs of strengthening in the fourth quarter. Commercial rents in Manhattan accelerated in the fourth quarter, as the market continued to tighten. New York City prime-area hotels continue to operate at close to full capacity, with room rates rising at a double-digit pace. Regional purchasing managers' reports indicate some slowing in the manufacturing sector, and a diminution of price pressures. Finally, local banks report further softening in consumer loan demand, and a further modest decline in delinquency rates.

Consumer Spending

Retailers report that sales were mixed but, on balance, close to plan in December. Major chains report regional comparable-store sales ranging from a slight decline versus a year earlier to a 7 percent gain, while smaller retailers in both New York and New Jersey averaged gains of 3-5 percent. Virtually all contacts say that sales were unexpectedly sluggish during the first two to three weeks of December. However, most report that a last minute spurt and strong post-holiday spending pushed full-month sales up to or slightly above plan. Most retailers report that inventories are in good shape, though a few cite some overhang, particularly of winter outerwear, which generally did not sell well. Overall, discounters appear to have fared slightly better than traditional department stores—most notably in the area of electronics.

Retail selling prices were said to be mostly flat; two major chains report a bit more discounting than in 1996, but a third says there were fewer markdowns. One contact notes that effective prices and profit margins were reduced because the bulk of sales came toward the end of the month (when there

is heavier discounting). Merchandise costs are said to be flat to down slightly; most contacts expect modest downward price pressure during 1998 due to falling prices of imports. While most retailers report difficulty recruiting seasonal help, none reports any perceptible increase in wage pressures.

Construction & Real Estate

Housing markets across the region appear to have gained steam during the fourth quarter. New Jersey homebuilders report that new home sales were relatively brisk in November and December, at both the lower and upper ends of the price range (though less so in the middle). Moreover, one large builder experienced unusually heavy customer traffic during the first weekend in January. Remodeling activity, which is already quite brisk, may strengthen further in 1998. A New Jersey building industry specialist notes that, on January 5, the state introduced a pilot program that eases some codes on remodeling existing units, thereby reducing costs; he expects this to spur renovation—not only of single-family homes but especially of dilapidated inner-city buildings.

Realtors in New York State report that existing-home sales were down slightly in November, but that prices rose noticeably—especially down-state, where they are running more than 10 percent higher than a year ago. Upstate prices were little changed. Separately, a large Manhattan brokerage firm reports a fourth-quarter surge in co-op and condo prices, following a third-quarter lull. Permits for new construction, however, have been essentially flat—both upstate and downstate.

New York City's office market appears to have tightened further in the fourth quarter. Midtown Manhattan's office availability rate (space coming available within the next six months) declined from 10.3 percent to 9.8 percent at the end of November, while Downtown's rate edged down from 17.7 percent to 17.6 percent. Asking rents in the tight Midtown Manhattan market rose at a double-digit annual rate over the past three months and are up 7 percent from a year ago. Downtown rates posted a more modest 4 percent rise over the past year but have also accelerated in recent months.

Other Business Activity

Regional purchasing managers report mixed but, on balance, weaker conditions in the manufacturing sector in December. Buffalo purchasing managers report that new orders fell noticeably in December, production retreated moderately, but hiring activity picked up somewhat. They also note a downturn in commodity prices. New York purchasing managers in both the manufacturing and non-manufacturing sectors report that business activity picked up slightly in December. Prices paid for goods and services edged up in December, though prices paid by manufacturers rose at a slower pace than in November.

In New York city, tourism and business travel continue to boom, as hotels are operating at virtually full capacity. Manhattan hotel occupancy rates held steady at just under 90 percent in October and November, while room rates were running 12 percent higher than a year earlier.

A substantial portion of upstate New York suffered a severe ice storm in early January. While its local impact was severe, the affected areas are sparsely-populated. Thus, it is not likely to have a substantial effect on the state's overall economy.

Financial Developments

Bankers at small to medium-sized banks in the District report softer demand for loans during the past two months. The consumer segment weakened most noticeably, with 42 percent of bankers reporting lower demand. Demand also declined for residential mortgage loans but remained stable for nonresidential mortgages and commercial & industrial loans. On net, refinancings remained level.

Bankers' credit standards did not change substantially over the last two months, though fewer respondents express an increased willingness to lend. Interest rates on all types of loans declined, as did average deposit rates. Delinquency rates continued to decline, particularly for consumer loans and nonresidential mortgages.

THIRD DISTRICT - PHILADELPHIA

Economic activity in the Third District continued to grow at a moderate rate in December and January. Manufacturers reported increases in shipments and orders in January compared with December, although there has been a reduction in orders from Asia. Retailers generally met expectations for increases in holiday sales of around 4 percent, in current dollars, from the prior year. Auto sales have been steady. Bankers indicated that business and real estate lending were growing in January, although consumer lending had eased seasonally.

Looking ahead, most of the Third District business contacts surveyed for this report expect moderate growth to continue. Manufacturers expect the overall pace of business to stay on an upward trend, although some firms with Asian customers said orders from that region will probably decline further. Retailers expect moderate growth in 1998. Bankers said they anticipate continued gains in business and real estate lending.

MANUFACTURING

Third District manufacturing firms contacted in early January reported improved business, on balance. About one-third said shipments and orders were rising, and fewer than one-fourth reported declines. Order backlogs, which had been falling since last fall, turned up for area firms, on the whole, although the rebound appeared to be slight. Employment at area industrial plants increased slightly in January compared with December, but work hours have been steady. Manufacturers continued to report difficulty finding skilled technical workers.

III-2

Among the major industrial groups in the region, demand seemed to be strongest for lumber, paper products, and nonelectrical machinery. Producers of industrial equipment and building materials reported declines in orders from Asia, and food processors generally reported a seasonal slowdown in their industry. Some area firms that face import competition expressed concern that foreign producers will increase shipments and reduce prices, but none of the companies contacted for this report has seen this occur yet.

Industrial prices have been generally steady, according to local firms. Three-fourths of the firms polled in early January said they were holding the line on the prices of their products, and around nine out of ten said the costs of the goods they purchase have been steady as well.

Looking ahead, Third District manufacturers expect moderately increased demand for their products, although they do not expect order backlogs to grow. On balance, firms in the region plan to add workers during the next six months and slightly increase capital spending.

RETAIL

Retail sales in the region met merchants' expectations for the Christmas shopping period overall, although performance varied considerably among stores. Most stores specializing in computers and other consumer electronic items had good year-over-year increases, but some apparel stores and department stores had just marginal gains despite heavy discounting. On the whole, according to reports from store executives, retail sales in the region probably increased around 4 percent, in current dollars, from 1996.

Area merchants expect some seasonal slowing in January, but they expect sales to move back up quickly and return to a trend of moderate growth. Nonetheless, merchants said competition is strong, and profit margins remain under pressure.

III-3

Third District auto dealers indicated that sales of new cars and light trucks have been running at a steady pace in recent weeks, but sales of used cars have slipped. With continued incentives from manufacturers, most dealers expect sales to remain near the current pace, although some dealers anticipate a slowing in sales of sport utility vehicles and light trucks.

FINANCE

Third District bankers contacted in early January generally said that loan volumes were rising at their institutions. Most indicated that commercial and industrial lending was moving up moderately, with new business coming mainly from middle market companies seeking either working capital or short-term financing to facilitate acquisitions. Commercial real estate lending was also said to be on the rise, with borrowing by well-capitalized developers of office and retail properties as well as some residential developments. Several bankers noted that residential mortgage lending has moved up recently, for both refinancing and home purchases. In contrast, consumer lending was described as slow, due mainly to seasonal factors. Several bankers noted that deterioration in personal loan portfolios, particularly credit card loans, appeared to be leveling off.

In their outlook for 1998, Third District bankers see continuing growth in commercial lending, but they expect competition among lenders to remain strong. They are concerned that loan margins will remain under pressure in the wake of the recent general decline in interest rates. Bankers expect real estate lending to continue moving up also, as construction activity expands and home sales increase in some parts of the District.

IV-1

FOURTH DISTRICT - CLEVELAND

General Business Conditions

District business conditions remain strong overall. While labor markets are reported to be “tight,” no broadly based acceleration in wages has been seen.

Employment agencies witnessed solid growth last year, with some firms posting placement gains of 30% from 1996. Computer programmers, as well as light industrial and construction workers, remain in high demand. In Kentucky, a good tobacco harvest has produced an unseasonably large rise in farm labor. One employment agency indicated increased demand for human resource personnel, as businesses have stepped up their recruiting efforts. The agencies also note a small rise in wages.

Organized labor is reporting yearly wage growth of about 3%, and a majority of respondents anticipate little change in this trend during the current year. Increased competition from abroad and low inflation are cited as factors restraining unions’ ability to press for larger wage hikes.

Construction in the District remains active in most areas. In Cleveland, all segments of the market—industrial, commercial, and public—showed strength in the fourth quarter. Stable material and labor costs have helped keep the rise in construction expenses moderate.

Contacts in the transportation and shipping industries report good growth in 1997, and some have noted record gains. International shipments have been a source of rapid expansion in recent years, and this pattern continued in 1997. The Asian financial crisis appears to have had little measurable impact on the industry thus far.

Manufacturing

Industrial production and orders growth remain strong. Capital goods producers report continued high demand, and shipments are at near-record levels. Steel production, although improved from the fall, remained steady at a relatively high level at year-end. Large truck manufacturing showed rapid growth in orders and production last quarter, nearing the industry peak rates of 1994-95. Indeed, order books here are generally full through midyear or beyond, suggesting continued high production levels in 1998.

Area manufacturers with Asian ties report a plunge in orders and foreign production activity. Adversely affected have been a few large capital goods makers and motor vehicle suppliers. Some “collateral” weakness from suppliers to the aerospace industry has also been noted. Overall, though, the direct impact of the Asian slowdown on the local economy appears to be limited.

Slight upward pressure on some industrial commodity prices is seen, most notably for paper products, but price increases remain modest overall. No significant materials shortages are noted, although concerns about labor availability continue to be heard.

Consumer Spending

District retailers report relatively good holiday sales (although performance varied greatly by store). Discount stores appear to have led other retail categories in sales growth during the season. Department stores fared less well. The volume of catalog sales rose sharply again in 1997, helped in part by the growing popularity of the Internet.

All respondents conceded that, while early December sales were slow, consumer spending rebounded sharply during the two weeks prior to the Christmas holiday. A

small majority of respondents indicated that overall sales for the month exceeded expectations, and some reported gains of as much as 5% from last year. Selling especially well during the holiday shopping season were electronics, housewares, and jewelry. Apparel sales were soft, and mild weather appears to have hampered sales of some seasonal items.

Retailers indicate that promotions remained “aggressive” throughout the holiday period. Although modest price hikes were noted at some smaller mail-order firms, most retailers said that price pressures remained light. Inventories now appear near desired levels, although some reports of excess stocks are noted at department stores.

Sales of new vehicles during December remained somewhat soft for cars, but steady to strong for minivans, sport utility vehicles, and small trucks. As a result, new car inventories are generally heavy. High rebates at the end of the 1997 model year are blamed for the recent sales slump.

Banking and Finance

Robust lending activity is reported in the District. Commercial loan demand is strong and continues to grow. Consumer loan demand is mixed, although a few banks cite a small improvement from our November report. Lower interest rates have also produced a jump in mortgage refinancing activity. Consumer loan delinquencies have stabilized at moderate levels, and commercial delinquencies remain very low.

The spread between borrowing and lending rates is narrowing, and competition in the commercial loan market is especially intense. Overall, though, credit standards are said to be holding steady.

FIFTH DISTRICT-RICHMOND

Overview: The Fifth District economy continued to expand moderately in late November and December, despite a sharp slowdown in the manufacturing sector. Service sector growth picked up in recent weeks and retail sales growth remained healthy. In the financial sector, lower interest rates boosted demand for home mortgages, while demand for consumer and commercial loans was steady. Housing activity was mixed; home sales were somewhat higher but housing starts were flat. The commercial real estate sector remained generally robust, although new construction activity continued to be modest in most areas. Labor markets were tight throughout the District. Wage growth picked up in the retail sector, but contacts reported only scattered wage pressures otherwise. Prices in the retail, services, and manufacturing sectors grew at somewhat slower paces than in our last report.

Retail: Fifth District retailers reported that sales growth remained strong during late November and December. Late November sales rose substantially, but contacts said that aggressive discounting was required to keep cash registers ringing in December. Retail prices increased more slowly than in our last report. Although retailers continued to report difficulties finding qualified workers, seasonally-adjusted employment in the sector edged higher and wage growth accelerated.

Services: Activity in the service sector grew at a somewhat faster rate since our last report. Contacts indicated that revenues grew more quickly. Employment growth held steady during November, but picked up in December. The overall rate of wage growth remained strong. Looking ahead, service producers remained optimistic about demand in coming months, though perhaps less optimistic than in our last report.

Manufacturing: The pace of manufacturing activity in the Fifth District slowed considerably since our last report. Shipments edged lower, and new orders and order backlogs fell sharply in December. Several textile producers indicated that their orders had been trimmed by increased Asian competition, but other manufacturers saw no Asian influence on their orders. Raw materials and finished goods inventories grew more rapidly and remained well above manufacturers' desired levels. Employment and wage levels changed little. Many contacts

continued to express frustration over shortages of skilled labor; others, however, suggested that labor availability had become less of a problem in recent weeks. Price growth for both raw materials and finished goods moderated. Manufacturers' outlook for the next six months continued to be optimistic; with orders and shipments expected to rise.

Tourism: Tourist activity was mixed during December and early January. Several sources from coastal areas indicated that unseasonably warm weather in early January boosted their business, while respondents from mountain areas reported that the recent "heatwave" and heavy rains hampered their business. One contact from a popular ski resort in Virginia noted that business was down 20 to 25 percent from a year ago. In West Virginia, however, the weather was more seasonable and bookings at ski resorts remained strong and in Washington, D.C., record visits at the Smithsonian Institute were noted.

Ports: Activity at District ports was unchanged to slightly lower since our last report. Decreased shipments of agricultural products, steel, and synthetic rubber pushed exports down somewhat, while reduced inbound shipments of tobacco, steel, and lumber products limited gains in import levels. Port operators indicated that developments in Asia had not noticeably affected export or import volumes.

Temporary Employment: Growth in the demand for temporary employees was slightly stronger during late November and December. Sources said that although some employers normally take a "breather" in their hiring at this time of the year, demand remained "surprisingly strong" compared to past years. Despite this, only scattered wage pressures were reported, mostly for jobs requiring a high degree of technical skill.

Finance: Mortgage lending rose moderately in recent weeks but commercial and consumer loan activity was little changed. Bankers reported that lower mortgage rates had spurred greater interest in home refinancings and fixed-rate mortgages. While competition for commercial loan accounts, particularly in the Carolinas, remained intense, contacts indicated that pricing spreads have been maintained. However, a Charleston, S.C., banker remarked that the intensively competitive environment had led his bank "to be more accommodating with loan covenants."

Residential Real Estate: Housing activity across the District was mixed since our last

report. Realtors in Richmond, Va., Greensboro, N.C., and Greenville, S.C., reported that home sales picked up, in part because of new companies moving into their areas. Sales of higher-priced homes were said to be particularly strong in some areas; a Virginia realtor noted that “baby boomers want all the frills in their dream homes.” Homebuilders, however, saw little change in housing starts and reported increased buyer interest in lower-priced houses. A West Virginia builder characterized his local market as one of “mostly bottom-feeders”-- individuals interested in purchasing lower-priced homes. In contrast, a contact from North Carolina said that prices of starter homes in that area had recently soared.

Commercial Real Estate: Since our last Beige Book, commercial real estate activity remained strong. Low vacancy rates persisted in many urban areas. Contacts continued to report only modest amounts of new construction in most areas, much of it small, pre-leased offices. But a few big projects were set to begin. In Richmond, Va., a \$3 billion computer chip plant received the green light after being on hold for several years. In the office sector, both Washington, D.C. and Maryland saw a tightening of Class A space. To help accommodate the demand for premier space in those areas, contacts noted that some Class B and C space was being renovated. In addition, a West Virginia realtor reported the conversion of older buildings to offices in his area.

Agriculture: Generally dry weather allowed District farmers to make significant headway in their fieldwork in December. Crop harvesting neared completion in most areas according to District contacts, although there were scattered reports of corn and soybeans remaining in fields. With harvesting nearly complete, analysts believed that yields of most crops would fall short of 1996 levels. As of late December, winter wheat emergence was only slightly behind the five-year average, and small grains were said to be in generally fair to good condition. In the livestock sector, fourth quarter hog inventories fell in several District states; a North Carolina analyst attributed the decline to increased shipments rather than to planned reductions.

SIXTH DISTRICT - ATLANTA

Summary: Reports from contacts across the Sixth District suggest that the Southeastern economy continued to expand moderately through the end of the year. Many merchants reported sales increased over last year's levels, but below expectations. Home sales have been flat recently, while nonresidential construction remained healthy. Manufacturing activity varied by industry. The tourism and hospitality sectors continue to perform well. Overall, loan demand grew moderately through the end of the year. Wage pressures and prices continue to be held in check despite reports of persistent labor shortages.

Consumer Spending: According to most District retailers, sales during December exceeded year-ago levels; however, many merchants reported sales were lower than their plans. Several retailers blamed slow apparel sales on unseasonably warm weather. Traditional retailers were hurt by the increase in nontraditional gifts such as spas and vacation packages. Reports indicate that high-end retailers and small specialty stores experienced a strong holiday season. Competition was intense and resulted in significant discounting by many retailers before and after Christmas. Despite lackluster sales, most retailers report that inventories are close to target, and sales will likely increase slightly in the first quarter on a year-over-year basis.

Construction: Builders reported that new home sales were flat-to-down compared with last December and construction activity was spotty. There are segments of the market where inventories are uncomfortably high. Looking forward, most Realtors expect home sales to exceed last year's levels, both in the first quarter and for the year. Builders anticipate the pace of construction in the first quarter will be similar to that seen during the fourth quarter. Multifamily development shows little change from the last Beige Book. Office and industrial construction

remains dominated by build-to-suit projects, although speculative development is becoming more widespread.

Manufacturing: Manufacturing activity varied with strength in some sectors, weakness in others. Contacts report that the economy in certain areas of Alabama is in surprisingly good shape considering the number of apparel job losses; the available labor supply has been absorbed by new and expanding firms. New Orleans contacts note that optimism remains high in the oil and gas sector, where equipment fabrication and manufacturing bookings remain at a strong pace. Although Georgia reports indicate falling new orders and shrinking factory workweeks for apparel producers, and decreasing factory payrolls and employment for some producers of consumer electronics and appliances, new orders are increasing for manufacturers of industrial machinery and fabricated metal products. Contacts in Alabama express concern that because of the Huntsville area's great exposure to the aerospace/defense sectors, some businesses that export or import could be impacted by problems in Asia.

Tourism and Business Travel: The tourism and hospitality industries continue to perform well. Tourism is still strong at central Florida theme parks, where several large expansions are underway. In Miami and Palm Beach, tourism continues to set records. Hotel and motel bookings through March are said to be ahead of last year's at the same time. In Louisiana, casino boat revenues in Baton Rouge are up by double-digits from a year ago, and Alexandria's new riverfront convention center is expected to boost the number of conventions booked to that part of the state.

Financial: Most banking contacts in the Sixth District report that overall loan demand grew moderately in recent weeks. Consumer loan demand increased slightly, while commercial lending remained strong and stable. Mortgage loan demand continued to grow.

Wages and Prices: Reports of labor shortages are continuing in parts of the District. Wage pressures are being held in check, however, according to most reports. In New Orleans, shipbuilders are seeking permission to hire foreign workers to fill their need for welders, shipfitters, electricians, and other workers. Contacts in Nashville report a shortage of labor for all major trade contractor categories. General contractors are reportedly concerned that subcontractors may not be able to acquire enough qualified workers to handle the volume of construction contracted out. Also, in Nashville, trucking executives report that the continued driver shortage is constraining growth. One Nashville company has been forced to idle over 10 percent of its equipment because of the labor shortage.

Prices for materials declined for some manufacturers. Some contacts note that businesses have not been able to increase prices, even though they have been trying; they are reportedly only able to achieve additional earnings through productivity increases. Reportedly, fierce competition is holding down price increases for finished goods.

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SEVENTH DISTRICT--CHICAGO

Summary. The Seventh District economy continued to expand moderately as the old year ended and the new year began. Consumer spending over the holiday season ended up in line with most retailers' expectations, despite unseasonably warm weather hindering the sale of some seasonal items. The normal seasonal slowdown in the region's construction activity was less pronounced than in the past, with December's warmer weather allowing more projects to be started. Manufacturers' plants continued to run near capacity, although new orders appeared to soften slightly in some industries, in part reflecting developments in Asia. Business lending activity remained brisk, and mortgage refinancing activity picked up noticeably as interest rates continued to fall. Shortages of skilled labor persisted in most areas and there were new reports of some projects being canceled as a result. Prices for most key Midwest farm commodities have declined considerably in recent weeks, adding to the likelihood of lower farm sector earnings in 1998.

Consumer spending. Most merchants were generally pleased with December's sales results. Consumers in the Midwest were reluctant to spend early in the month, but sales activity picked up dramatically the week of Christmas and continued strong through the post-holiday sales events. Despite consumers waiting until the last moment to do their holiday shopping, there was very little use of unplanned discounting to clear inventories. These results were nearly universal across store types--with discounters as pleased as department stores--although one large national chain reported District sales to be well below expectations, but in line with their national results. Most merchants noted that sales of appliances, electronics, jewelry, and consumables were exceptionally strong, while apparel did well. Sales of some seasonal merchandise, such as snow-blowers and outerwear, were hampered by unseasonably warm weather in December. Despite their earlier concerns about shortages, none of the merchants contacted indicated that the availability of seasonal help had any discernible impact on sales.

Housing/construction. Overall construction activity remained robust with the seasonal slowdown less than usual. As in our last few reports, the commercial segment was stronger than the residential side, although the latter showed a slight rebound in December in some areas. Homebuilders in Wisconsin and Illinois said that unseasonably warm weather had boosted traffic in December, usually one of their worst months, which subsequently boosted sales. Most

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homebuilders in the District expect 1998 to be down slightly from last year's very high levels, though December's strong showing made some less certain. The commercial segment experienced a normal seasonal slowdown, but most contacts felt that it was less pronounced than in previous years. Public projects remained very strong and expectations for 1998 were very high among contacts in this segment. One District materials supplier suggested that this is the highest level of public construction activity he had seen in years.

Manufacturing. The District's manufacturing sector was very strong and continued to expand at the end of 1997, but momentum may have been slowing slightly heading into the new year. Though most contacts noted that production continued to be near capacity, new orders--previously described as "strong"--were generally described as "holding up," and inventories--which had been "lean"--were being called "okay." The Midwest's strong construction industry continued to boost sales of heavy equipment, and construction equipment dealers were reported to be "crying for more inventory." Strong motor vehicle sales in December bolstered production for the District's automakers, although one contact worried that December's strong showing may have borrowed from January sales. Most producers expected light vehicle sales to soften slightly in 1998 but to remain near the very good 15 million unit level. A major producer of high-tech components indicated that new orders were softer than at this time last year, but that the company "can live with it." The pricing environment for most manufacturers remained very soft and raw material costs were either flat or down in most instances.

The turmoil in Southeast Asia has begun to filter through the manufacturing sector since our last report. Heavy equipment producers appeared to be influenced most directly, with exports to the region falling off noticeably. One producer described the Asian market as "a disaster," as the company's sales to the region were cut nearly in half. The District's automakers expressed some concern that competitors from Southeast Asia would increase the use of incentives in the U.S., though there were few reports of this taking place recently. This would further soften the pricing environment for the industry.

Banking/finance. Bankers in the District suggested that lending activity remained very strong as 1997 drew to a close. As was the case in our last few reports, commercial lending was stronger than consumer lending, with one large bank noting that loan growth was "outstanding." While business lending activity normally picks up at the end of the year, one major bank reported an extraordinary increase in December which showed no signs of slowing in early January.

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Other banks noted that the growth in business loans had tapered off somewhat, but remained at very high levels. Competition for quality commercial customers remained very fierce and margins continued to be squeezed. On the consumer side, the big story was a sharp increase in mortgage refinancing activity. Falling interest rates lured many homeowners back into the mortgage market in December and one major bank reported that refinancing now accounts for over 60 percent of new applications, up from approximately 30 percent. Overall asset quality was unchanged, with most contacts describing it as "excellent."

Labor markets. Labor markets remained very tight through December and early January, although the steady decrease in the region's unemployment rate appeared to have ended. The average unemployment rate, which began declining in mid-1992, flattened out in the latter half of 1997 and may be trending upward ever so slightly. The major concern of employers, however, continued to be labor shortages. Though these shortages were broad-based, information technology and construction workers were most often cited as being in short supply and accounting professionals were again hard to find heading into the upcoming tax season. A major producer of high-tech equipment reported that some projects had to be scuttled because of the shortage of engineers. Homebuilders' associations in Wisconsin recently began setting up recruiting booths at some of the state's "home shows." The shortages continued to hinder the District's employment growth and most analysts contacted expect this to continue into 1998. A survey of employers' hiring plans forecasted that the Midwest's payrolls would continue to expand in the first quarter of 1998, with Detroit and Milwaukee area employers being the most optimistic. Wage pressures generally remained subdued, with new reports of increasing wage gains generally confined to those occupations where skill levels were upgraded, such as upper-end administrative staff with project leadership or report writing skills.

Agriculture. Prices for most key Midwest farm commodities have declined considerably in recent weeks, adding to the likelihood of lower farm sector earnings in 1998. Sluggish export prospects, compounded by recent problems in several Asian markets, contributed to the price decline for both crops and livestock. Livestock prices were further undermined by a seasonal rise in domestic hog marketings and by a bulge (presumably temporary) in hogs imported from Canada, where labor strikes curtailed operations at several packing plants. In addition, recent surveys confirmed a major buildup in the number of hogs on U.S. farms during the latter half of 1997, foreshadowing large gains in pork production for much of this year.

EIGHTH DISTRICT - ST. LOUIS

Summary

Despite reports of modest retail sales growth during the holiday season, the District economy started the new year showing signs of continued moderate growth. Manufacturers and other business contacts remain optimistic, with orders and inventories at desired levels. Residential construction slowed somewhat in the fourth quarter, while nonresidential construction remained strong in southern parts of the District. Loans outstanding at large District banks rose moderately in the final two months of 1997. District sales tax collections suggest that spending weakened somewhat in the fourth quarter. Contacts in the agricultural sector continue to anticipate a slowing in farm exports because of the crisis in Asia.

Consumer Spending

Retailers report that sales increased between 2 and 3 percent on average during the 1997 holiday season over a year earlier. About one-quarter of our contacts report that sales were below expectations, despite what seemed like a strong start for the season. Toys and electronic equipment were the strongest sellers, while unseasonably warm temperatures left winter clothing out in the cold. Non-auto inventories are currently at desired levels, so most contacts do not anticipate needing more-than-usual discounting to move merchandise. Retailers expect moderate-to-strong sales during the first quarter of 1998 because of heightened consumer optimism about the economy.

Automobile dealers report mixed sales growth for November and December over a year earlier. Those with sales increases cite lower interest rates, larger rebates and incentives, and stronger local economies as reasons. Those with sales declines blame rising consumer debt levels and tighter credit standards as reasons. More than half of the respondents have used rebates

extensively to move stock. But, for the most part, current auto inventories are too high. Generally, though, dealers are optimistic about the first quarter of 1998.

Manufacturing and Other Business Activity

District contacts remain optimistic about economic conditions in 1998, despite continued difficulties with tight labor markets. Some contacts have noted that they have been unable to meet demand because of a shortage of workers. To combat this shortage, one firm is subsidizing bus service from high-unemployment areas to its plant. Most contacts report wage increases of 3 to 4 percent.

Orders and inventories at most District manufacturers are at expected levels. A contact in the meat packing industry, for example, reports a “booming” market because of low pork prices and high demand for sausage products. Even though auto sales have been somewhat sluggish, some suppliers to the auto industry are expanding. For instance, a new stamping plant will open in southern Indiana. The District aerospace industry also got a boost from an expansion of a current Navy contract for jets. UPS reports that its Louisville hub is running even with or a bit ahead of both 1996 levels and 1997 projections. Sluggish sales of home appliances, however, led one company to let its seasonal workforce go early. Slowing apparel sales have led a St. Louis-based retailer to reduce employment by another 100 workers.

Real Estate and Construction

Following a usual seasonal pattern, monthly residential permits in November were down in all District metropolitan areas, except Texarkana, Ark. Year-to-date permit levels, however, were up in four of the District’s 12 metro areas. Contacts report that construction of higher-priced homes (more than \$250,000) is strong in many areas, although they say it’s not clear there is adequate demand for this housing. Much of this construction is speculative. The Delta region

of the District is reportedly experiencing strong commercial construction, especially of catfish farms.

Banking and Finance

Total loans outstanding at large District banks rose 2.6 percent in the last two months of 1997; one year ago, loans had risen 1.1 percent during the same period. Commercial and industrial lending was particularly strong at year-end, rising 2.2 percent in the final two months of the year; real estate loans rose 1 percent, while consumer loans increased just 0.1 percent.

State Sales Tax Receipts

Current tax data show that monthly growth in sales tax receipts has been slowing, perhaps signaling a modest retrenchment in the pace of consumer spending. For the three months ending in September, year-over-year growth in receipts was 7 percent. In October, it was 6 percent, and early indications are that November's growth rate was below 6 percent. A cut in the sales tax on food items in Missouri, however, likely explains part of this slowing in the growth rate.

Agriculture and Natural Resources

Contacts in the agricultural sector, particularly those from the rice- and cotton-growing areas, continue to anticipate a decline in farm-related exports to Asian markets. A large farm machinery dealer reports that prices of used machinery have picked up recently; however, price increases for new farm machinery are below those seen last year at this time. Substantial increases in farmland prices—primarily for “good” farmland—have been noted by a few contacts recently. Most believe this reflects isolated instances of farmers securing adjacent farmland, rather than speculative buying.

NINTH DISTRICT--MINNEAPOLIS

As 1998 opens, the Ninth District economy is like a marathoner – maintaining a strong, steady stride, but not sprinting. Business people are optimistic about prospects for the new year. Construction, manufacturing and energy development are all robust. Retail sales were strong at the end of 1997, and merchandisers are generally optimistic about 1998. Banks enjoyed a very good year and anticipate another.

Agriculture varies somewhat by crop and location, but farm finances are generally strong. Due to lack of snow, tourism is weak in some areas. Difficulty in securing employees is the most widespread economic complaint. Despite reports of rising wages for many specific skills, output prices are quiescent.

General business conditions

“Solid growth predicted for all states,” headlined the report of a December regional survey of purchasing managers. This sentiment was echoed by business leaders responding to a year-end Ninth District poll. Nearly 60 percent expect business investment to be up in their communities versus 8 percent predicting a drop. Over 54 percent expect employment to rise compared to 5 percent anticipating a drop. In terms of their own firms, 59 percent look for higher sales and 46 percent anticipate making increased investments.

Manufacturing

Some 61 percent of Ninth District manufacturers polled in late 1997 expect 1998 sales to be up, only 4 percent expect them to slump. Over one-third anticipate increased investment by their own firm. These figures reflect a manufacturing sector that continues to enjoy robust business with continued growth in orders. Only a few firms report slackening export orders from Asia that will significantly affect their business. However, a December multi-state regional purchasing managers’ survey did note some slowing of growth for the Dakotas and widespread reports of slower export orders. Computer networking products and services remain very strong, as do medical electronics and devices.

Construction and real estate

Construction has been strong for so long in the district that a fast pace has become the norm. Moreover, unusually warm weather favored strong activity into January. Publicly let awards in Minnesota and the Dakotas for all 1997 ended up 11 percent above 1996. Industry sources expect similar strength in the new year. A report on commercial real

estate in the Minneapolis-St. Paul area detailed low vacancy rates and plans for increased construction in downtowns and suburbs.

Housing construction is strong in most urban areas. Many sources report that low interest rates are heating up buyer interest in both new and existing housing, and lenders are bracing for a spate of refinancing.

Natural resource industries

The mild winter has fostered energy development, with a record 35 rigs drilling for oil or gas in North Dakota and Montana at the new year. North Dakota oil production is up 11 percent over year-earlier levels. After registering strong or moderate growth in the last two years, iron ore mining officials expect essentially stable output in 1998. Output is similarly stable for most forest product producers. One small Wisconsin paper plant may be closed as a result of post-merger restructuring.

Agriculture

“Due to good yields we should see debt reduction for most farmers in first quarter 1998,” reports a southern Minnesota banker. “Many farmers and ranchers are leaving the area due to poor prices and weather conditions,” says a southwest North Dakota counterpart. These comments illustrate the mixed financial conditions in agriculture. Corn, soybean and hog farmers in eastern South Dakota, southern Minnesota and western Wisconsin are enjoying good profitability and favorable weather. Cattle ranchers and feedlot operators generally report moderate profitability after 2½ years of losses.

Wheat and dairy producers are squeezed by prices that do not allow them to cover all costs. North Dakota and northwestern Minnesota farmers continue to suffer poor cash flows due to 1997’s excess moisture, plant disease and insect infestations that cut yields dramatically in many areas. Despite these problems, farm finances are described as strong by most district bankers.

Consumer spending and tourism

“Late rally helps retailers in holiday season,” headlined a newspaper story on sales by Minnesota-based national firms. A general retailer and a music and video chain reported same-store increases of 6.4 percent and 8.7 percent respectively over the 1996 holiday season. A consumer electronics and appliance chain reported 12.6 percent year-over-year

same-store gains for December. Regional firms, mall managers and individual store owners are generally upbeat on both the holidays and prospects for first quarter 1998.

Vehicle sales are mixed. Dealers and association representatives in Montana and the Dakotas describe sluggish to average sales in many areas. But sources in urban areas of Minnesota, western Wisconsin and the eastern fringes of North Dakota and South Dakota are somewhat more optimistic, reporting good, but not booming, sales

“No white means no green,” is a headline that applies to most winter recreation or tourism businesses. A tourism official reports that the lack of snow has hit some counties hard in the Upper Peninsula of Michigan, especially during the holidays. "It will take a lot to bail out the winter," he says. While snow cover is light on the lower elevations in South Dakota and Montana, there are good conditions at higher elevations. A ski resort in Montana reports a solid holiday season and projects a season on par with last year.

Banking and financial services

While 1997 was a very profitable year for many banks, a variety of sources describe demand for bank loans as softening, reportedly because of strong internal cash generation on the part of many businesses. Stiff competition to make loans has reportedly led to reductions in loan pricing. Bankers reportedly expect a good year in 1998, but some express concern about how long the "good times" can last.

Employment, wages and prices

Tight labor markets continue as a major problem for employers in most areas of the district. Nearly 83 percent of firms polled in a Ninth District survey report securing workers to be a challenge. Reported compensation increases continue to be mixed: Many firms report having to up their bids significantly to secure skilled specialists, but firmwide pay increases of 2 percent to 3 percent are also common. Several sources report that health insurance costs will be up markedly in 1998 after a three-year hiatus.

Gasoline and heating oil prices are at their lowest levels in this decade. Spot natural gas prices declined from December into the new year. The combination of lower prices and warm weather has significantly reduced heating costs for most homeowners. Manufacturers of intermediate goods continue to describe pressure from customers to lower prices. Reports of price increases for intermediate or final goods are extremely rare.

TENTH DISTRICT - KANSAS CITY

Overview. The district economy continued to grow moderately the past month. Retail sales increased over the holidays, energy activity improved, and manufacturing activity remained fairly strong. The only sign of weakness was a slight slowdown in construction activity. In the farm economy, the winter wheat crop is in good shape and ranchers are expected to benefit from good quality pasture. Labor markets remain tight in much of the district, with more evidence of wage pressures than in the recent past. Prices edged up for some manufacturing materials and at the retail level.

Retail Sales. Retailers report sales increased last month during the holiday season but were generally unchanged from a year ago. Retailers remain optimistic that sales will hold steady or edge up over the next three months. Most retailers were satisfied with current stocks but expect to trim inventories slightly in the coming months. Automobile dealers report sales edged up last month but were slightly lower than a year ago. Sales of sport utility vehicles remained strong, while sales of other vehicles held steady. Dealers have kept inventories unchanged as they expect no major shifts of sales in the coming months.

Manufacturing. Manufacturing activity continued to expand last month, with plants operating at moderately high levels of capacity. Purchasing agents reported some difficulties obtaining materials due to rail-shipping delays, which increased lead times. Some agents expect rail-transportation problems to continue in the near future. In spite of a moderate decline in inventories last month, most manufacturers say they plan further reductions because stocks exceed desired levels.

Housing. Builders report housing starts were down slightly last month but up somewhat

from a year ago. Builders anticipate a normal seasonal improvement in construction activity in the coming months. Sales of new homes edged down last month due primarily to seasonal factors, resulting in a slight increase in inventories of unsold new homes. Most building materials were readily available and delivery times were normal. Mortgage lenders say demand was unchanged last month, but demand is expected to increase somewhat in coming months as more consumers refinance mortgages.

Banking. Bankers report that both loans and deposits increased last month, while loan-deposit ratios edged downward. Loans increased in all categories except consumer loans and home equity loans, which were flat. Increases in demand deposits, NOW accounts, and money market deposit accounts outweighed declines in large CDs and small time deposits.

All respondent banks left their prime lending rates unchanged last month and most expect to hold rates steady in the near term. Most banks did not change their consumer lending rates and anticipate no future changes. Lending standards were unchanged at most banks.

Energy. District energy activity improved last month after declining for three consecutive months. Crude oil prices fell but not as much as natural gas prices. Both prices remained well below year ago levels. Despite lower prices, the district rig count was up 11 percent in December to a level 17 percent higher than a year ago.

Agriculture. The district's winter wheat crop is in good shape with favorable growing conditions, and wheat pasture is reported as good to excellent. Good quality wheat pasture should benefit ranchers planning to graze calves through the winter. Area bankers indicate that ranchers have experienced a rebound, and cattle loan portfolios are healthier than a year ago. The railroad shortage did not appear to have a significant impact on district producers and businesses.

However, the shortage of rail cars did pose a slight delay in transporting grain.

The financial condition of district farmers is extremely strong, perhaps the best in recent years. The majority of the farm loan portfolios in the district are doing well, with very few loans turned down due to financial weakness. Loan demand is expected to increase in grain-producing areas, while areas of the district that produce livestock are not anticipating an increase in demand. Due to healthy profits for district farmers, farm equipment dealers are enjoying a substantial increase in sales, while auto and truck sales have risen more slowly.

Wages and Prices. Labor markets remained tight last month in much of the district, with somewhat more evidence of wage pressures than in previous reports. Retailers and manufacturers report a shortage of workers at almost all levels. Builders say framers and other skilled tradesmen are hard to find. And respondents from many firms complain that computer-related positions can not be filled. Some companies have raised wages more than in the recent past to attract or retain workers, while many say wage increases were about average. Most retailers report steady prices, while a few say prices edged up last month. Prices increased slightly for some manufacturing materials, such as metals, while prices of construction materials held steady. Retailers expect prices to decline slightly in the coming months.

ELEVENTH DISTRICT--DALLAS

In December and early January, Eleventh District economic activity grew at a slightly slower pace than reported in the last Beige Book. While prices of most manufactured products were flat or down, services and some construction-related industries saw price increases. Manufacturing and retail firms reported slightly slower sales growth, while service industries said sales growth was up. Most contacts anticipate— but have not seen—effects from the Asian crisis; a few attributed recent price and sales declines to the situation. Energy and construction activity remained strong. Loan demand was unchanged, and agricultural conditions remained favorable.

Prices. With the exception of food and some construction-related products, most goods-producing contacts reported prices decreased or remained steady. In contrast, service industry contacts reported rising prices. Contacts in the lumber, retail apparel, paper and metal industries expect the Asian crisis to cause price declines in coming months.

Prices of poultry, feed grain, beef, pork loin, pine lumber, memory chips, crude oil and refining products were reported to be down. A few retailers reported they are also seeing lower prices for a variety of Asian imports. Contacts attributed much of the decline in memory chip prices to worldwide excess capacity, but also believed events in Asia played a role. Contacts reported crude oil prices were hit hard by unseasonably mild weather, the resumption of Iraqi oil sales, and expectations of a decline in Asian demand. Crude oil prices, which averaged \$21 to \$22 per barrel in October, slipped to about \$17 by early January. Retail gasoline, heating oil and natural gas prices were also reported to be down.

Prices of primary and fabricated metals, plastics, petrochemicals, telecommunications products, and paper were generally flat. Petrochemical prices held steady despite the addition of three ethylene facilities over the past month because strong construction activity in late 1997 depleted inventories of construction-related plastic products and the petrochemicals from which they are made.

Prices increased over the past six weeks for fruits, vegetables, some processed foods, hardwoods, brick and cement. Food industry contacts reported prices rose because of a cold snap which knocked out 80 percent of

Mexico's crops. Contacts reported that high levels of construction activity led to increased cement prices and shortages of skilled workers in construction and construction-related industries. Brick and hardwood lumber producers said wage increases fed through to product price increases of 2 percent to 3 percent since the last survey.

Service-producing contacts reported increases in prices in the past six weeks. Passenger airlines reported unusually high demand for the post-Christmas season, with record load factors and an 8-percent fare increase. Service sector growth translated into increased recruiting of skilled and semiskilled workers, higher compensation, and in most cases, higher prices, although there were some reports of squeezed profit margins.

Manufacturing. Growth in sales was slightly lower for manufactured products. Sales of semiconductors and heating fuels, and some construction materials—such as fabricated metals, cement and some lumber products—softened slightly over the last six weeks. Economic turmoil in Asia reduced sales of some manufactured products, particularly semiconductors, but the magnitude of the effect is not yet known. One semiconductor producer noted that, while his revenue forecasts have not changed significantly, the uncertainty surrounding the forecasts has increased sharply because of events in Asia. However, manufacturers of telecommunications equipment and lower-priced microprocessors reported continued, steady growth. Sales of products used in residential construction rose slightly. Shipments of paper products are down seasonally, but strong year-over-year, and inventories remain low. Sales of apparel increased. Warm weather reduced sales of heating oil and natural gas (and increased inventories) but also stimulated unusually strong winter gasoline sales.

Services. Business service firms reported an increase in activity late last year driven by strength in mergers and acquisitions, real estate transactions, banking and manufacturing. Business service contacts expect reduced demand from customers who export to Asia. Freight forwarders reported a decline in export tonnage. Domestic cargo shipments remained strong. Although some contacts reported improved rail service during the past six weeks, others saw little improvement in bottlenecks.

Retail Sales. Retailers reported that sales were slow in the first part of December but picked up strongly right before and right after Christmas. Contacts indicated that overall sales were less than in previous

years, partly because of increased competition. Retailers also reported sales were lower because consumers now spread their purchases over the entire year and spend more of their income on leisure activities.

Retailers said inventories have been in good shape for some time, and as a result, markdowns have not been big.

Financial Services. Loan activity kept a constant pace, contrary to some respondents' previous expectations of slowing in the fourth quarter. Competition for commercial loans remained strong but eased for consumer loans. Delinquency rates remained stable "at comfortable levels." Preliminary reports were mixed about the use of home equity loans that became available in Texas at the first of the year. Consumers and bankers were still learning the details of the new law.

Construction and Real Estate. Construction and real estate activity continued to expand, led by increases in residential and office construction. Despite increased construction, strong sales of single family homes left inventories low. Builders of lower-priced starter homes reported that lower interest rates are stimulating sales. Office rents continued to rise sharply, and similar increases are expected in 1998. Although current construction is expected to be absorbed, an increase in speculative building left some contacts concerned about possible overbuilding in the future. Pre-leasing was down in the industrial real estate market, but demand was expected to keep pace with new supply through 1998.

Energy. Demand for oil field services remained very strong, with continued reports of inadequate capacity. Weak energy prices had not yet affected drilling activity, and are not expected to do so unless prices fall to less than \$17 per barrel for a sustained period.

Agriculture. Overall agricultural conditions remained favorable. Small grain production benefited from wet weather in most areas. In the northern portion of the District, however, snow and cold temperatures hurt some livestock operations.

TWELFTH DISTRICT—SAN FRANCISCO

Summary

Reports from Beige Book contacts indicate favorable economic conditions among 12th District states in the final months of 1997 and suggest a positive, although more tempered, outlook among respondents for 1998. Retailers reported that holiday sales, though stronger than last year, were lower than expected, prompting considerable post-season discounting. Respondents throughout the service sector reported healthy gains in recent weeks, and shipping and trucking contacts noted easing of recent bottlenecks associated with the Union Pacific Railroad merger. Manufacturers reported healthy activity, but noted declines in exports to East Asian countries. Developments in East Asia also have reduced demand for many District agricultural products. Steady demand for commercial real estate kept construction activity strong in most of the District, despite a slowdown in many housing markets. District financial conditions remained healthy, and competition for quality borrowers continued to be intense.

Business Sentiment

District respondents expect solid performance of the national economy and their respective regional economies. Most respondents expect national GDP growth to slow to its long-run average pace, leaving the national unemployment rate near its current level. A majority of respondents expect inflation to remain constant over the next 12 months, although a growing fraction anticipate a slight decline in inflation. With regard to regional conditions, over three-quarters of the respondents expect growth in their area to outpace national growth in the coming year. Recent disruptions in East Asia have affected export expectations in the District—more than 80 percent of District respondents expect a decline in foreign exports from their regions.

Retail Trade and Services

Respondents in most areas of the District characterized holiday retail sales as better than last year but lower than expected. High-end gifts, such as jewelry and branded apparel, reportedly posted the strongest sales, requiring little pre-Christmas discounting to attract buyers. In contrast, retail contacts reported disappointing sales of inexpensive and moderately priced clothing and personal electronic items, despite early heavy discounting. Overall, slower than expected holiday sales, particularly at department stores and discount chains, reportedly have left many retailers with unwanted inventories that are being cleared away through deep price cuts.

Service industry respondents in most of the District reported good gains during the recent survey period. Respondents from Northern California and the Pacific Northwest reported healthy demand for business services, including consulting and advertising. Tourism-related airport traffic and hotel occupancy rates increased in several areas of the District. In Portland, air passenger traffic reportedly was at record levels. In San Diego, hotel occupancy rates reportedly reached a decade high over the past few months. The news was not as good in Utah and Hawaii. In Utah, a lack of snow has slowed the flow of ski-bound tourists; in Hawaii, recent developments in East Asia have significantly depressed East-bound visitor traffic, prompting many airlines to reduce the number of scheduled flights to the state. Port traffic throughout the District reportedly was strong. Inbound traffic from East Asia has offset declines in outbound vessels carrying products to East Asia. Respondents in the shipping industry also indicated that the bottlenecks associated with the Union Pacific Railroad have subsided slightly in recent weeks.

Manufacturing

District manufacturing reports generally were positive, although contacts noted that

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developments in East Asia have reduced exports and tempered growth in some areas and industries. In the Pacific Northwest, food processors and lumber and wood product manufacturers reportedly have experienced substantial declines in exports to East Asia, prompting some companies to postpone expansion plans until the region stabilizes. Boeing also has felt the effects of East Asia; public statements from Boeing indicate a slowdown in the growth of aircraft orders and requests for delivery delays from East Asian countries. However, given the backlog of orders at Boeing, no decline in production is expected this year. In other areas of the District, contacts reported declines in shipments of primary and secondary metals to East Asian countries and slowing of orders for telecommunications equipment.

Agriculture and Resource-related Industries

Reports on District agricultural conditions and resource-related industries were mixed. Falling gold prices resulted in the recent shut down of operations at a number of District mines. The cattle industry was beset by herd losses due to unfavorable weather and grazing conditions, particularly in the Intermountain states. Demand for many agricultural commodities slowed in recent weeks as East Asian countries either cancelled orders or failed to secure appropriate lines of credit for purchase. On the bright side, reports indicate that the Union Pacific railway problems have begun to ease, clearing the way for delivery of inputs that are necessary for the next growing cycle.

Real Estate and Construction

Commercial real estate activity continued to increase in most areas of the District, keeping District construction activity at high levels despite a slowdown in many housing markets. Respondents in many areas of the District outside of California noted declines in new housing

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starts and slowing sales of both new and existing homes. However, commercial real estate and construction activity in these areas remains strong and has kept demand high for contractors, subcontractors, and materials.

Financial Institutions

Twelfth District banking conditions continued to be healthy. Respondents reported that bank capital and liquidity were in ample supply and competition for loans remained intense, with quality borrowers receiving excellent terms and rates. Respondents noted that low interest rates are boosting loan demand and encouraging refinancing on all types of real estate. Throughout the industry, shortages of qualified workers continued to be a primary concern, and wage and salary pressures remained high.