Summary of Commentary on

Current Economic Conditions

by Federal Reserve District

March 1998
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BY FEDERAL RESERVE DISTRICT

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SUMMARY¹

All district economies continue to show overall strength, but a few have noted some recent moderation in their rates of growth. Retail sales are generally up in most districts, exceeding retailers’ expectations in many of them. Auto sales, however, are generally down, although demand for pickup trucks and sport utility vehicles remains high. Industrial activity is on the rise in most parts of the country, with orders and production up. Most districts, though, are experiencing a decline in exports to Asia. Continuing the theme of recent reports, the demand for labor remains strong, with nearly all districts reporting shortages of workers at the entry level and in certain skilled categories. Widespread labor market tightness appears to have increased the degree of wage pressures compared with recent reports. Pressures on product prices remain eerily calm, as domestic competition, productivity gains and the Asian situation help to constrain production costs. Residential housing markets, buoyed by low interest rates and mild weather in many districts, are unseasonably hardy. Commercial real estate markets are healthy across districts. Loan demand, especially for residential mortgages, remains strong in most districts. Agricultural conditions are mixed, with some districts reporting that an abundance of precipitation has harmed crop prospects and delayed field preparation activities.

Consumer Spending

Most districts report that January and February sales are up from one year ago. The Boston, Chicago, Cleveland, Dallas, New York and Richmond districts report that sales have generally exceeded retailers’ expectations; in the Atlanta and St. Louis districts, sales have generally met expectations. Almost all districts report that unseasonably mild winter weather has

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helped boost sales of items in many categories, especially home improvement products, furniture and building materials. Sales of winter clothes, however, have suffered in most parts of the country. The New York district notes that contacts experiencing weak retail sales have usually cited mild weather as a cause. The Atlanta, Chicago, Cleveland, New York and Richmond districts report strong sales of spring clothes, particularly for women; the Boston and San Francisco districts note that apparel sales are down. The San Francisco district adds that department store sales in Southern California are also down. Most districts report that retailers’ inventories are at desired levels, although some contacts in the Kansas City and St. Louis districts report that inventories are too high.

Auto sales in most districts are down from one year ago. While sales of pickup trucks, sport utility vehicles and minivans remain strong, sales of passenger cars are either flat or down. The Richmond district reports, though, that sales of new and used vehicles have exceeded expectations. The Dallas district notes that vehicle sales surged in January, before slowing somewhat in February. Almost all districts report that vehicle inventories are too high, although contacts in the Kansas City district are satisfied with their stocks. Contacts in most districts expect some strengthening in sales this spring.

Manufacturing

Almost all districts report steady or increasing growth in industrial activity, although the Dallas district notes a slight weakening in growth. The Chicago district reports that activity is robust, with nearly every sector operating near capacity, while Kansas City district contacts report that current operations are at moderately high levels of capacity utilization and expanding. The Cleveland district notes that, although production is up at most surveyed firms, the number reporting a slowing in production has risen. The Richmond district describes a resurgence of
activity, with sharp rebounds in orders and shipments. The Chicago, Cleveland, Minneapolis, New York, Philadelphia, St. Louis and San Francisco districts also report hikes in new orders, while the Kansas City district has seen a mild decline.

Makers of building materials and related products generally report continued brisk or rebounding sales due to strength in construction markets. The Dallas district, however, notes that sales of construction materials are down because of a wetter than usual February. Aircraft and heavy truck parts, primary and fabricated metals, and steel production are reportedly strong in the Boston, Chicago, Cleveland, Minneapolis, St. Louis and San Francisco districts. Demand for business services, particularly real estate services, and telecommunications services is up in the Richmond and San Francisco districts. Contacts in the Dallas district, though, report that sales of telecommunications equipment are essentially flat.

The apparel industry is in decline in almost all districts. Plant closings, falling sales and declining orders are common, reflecting both increased import penetration and a weakening of export demand. Just about every district reports that exports of many goods to Asia are dropping. The Richmond district, however, notes that activity in the district, except in the textiles industry, has not been affected by the Asian situation. The Boston district adds that the strong dollar has been hurting exports to all parts of the world, not just to Asia.

**Labor Markets**

The tone of this report is largely unchanged from that of recent reports: Taut labor markets continue to hamper business activity in a variety of ways. In general, the apparent imbalance between the demand and available supply of workers remains the dominant theme, with the majority of district reports suggesting that the supply of entry-level and skilled workers—most often in technology-related fields, but also in construction and certain skilled
craft positions—appears to be insufficient to meet existing production schedules. In the St. Louis district, for instance, contacts note that UPS is concerned it will not be able to find enough workers to staff a major expansion.

Firms have used a variety of methods to ameliorate these shortages. For example, in the Boston and Cleveland districts, firms are hiring temporary workers and outsourcing production more often, while in the Atlanta, Chicago and Kansas City districts, firms are resorting to worker training programs and various incentive or award programs.

Wages and Prices

With labor markets stretched to the limit in many areas, there have been reports of rather large wage increases—although this is by no means consistent across all districts. In the Boston district, vigorous demand at temporary employment agencies has produced wage increases of up to 15 percent; wage increases in the retail sector are running 4 to 6 percent higher than the previous year, while wage increases in manufacturing are running at 3 to 5 percent. Wage gains appear to be more measured elsewhere in the country. The Cleveland district reports wage gains of 3 percent, while the Minneapolis and San Francisco districts report wage increases of anywhere from 0 to 4 percent. The Atlanta and Richmond districts report somewhat faster wage growth in the retail sector, but note that overall wage gains are modest to subdued, which is similar to the Chicago and Kansas City district reports.

Price pressures appear to be less pressing than wage pressures, according to most district reports. Manufacturing raw materials costs have reportedly increased little, if at all, in the Boston, Chicago, Cleveland, New York and Philadelphia districts. At the same time, nonmanufacturing firms in the New York district, as well as manufacturing firms in the Kansas City and St. Louis districts, note higher input prices. In addition, a few districts continue to
report that competitive pressures and productivity gains have worked to offset higher materials
prices and to limit product price increases. Although a few firms in the Chicago district have
attempted to raise their selling prices, these efforts have not been entirely successful.

The evolving Asian situation has had some depressing effect on prices, according to most
district reports. The Dallas district reports that Asian currency movements against the U.S. dollar
have caused widespread declines in the prices of commodities, computer components and
petrochemical products. In the Atlanta district, some import prices have fallen, although not
among importers with fixed contracts. Meanwhile, retailers in the New York district report that
no significant price declines in consumer goods have occurred.

Construction and Real Estate

Every district reports strong residential housing market conditions. New home
construction is described as unseasonably brisk in several districts, including Boston, Chicago,
Cleveland, New York and St. Louis. Mild winter weather, high consumer confidence and low
interest rates are credited with much of this strength. However, in several districts, such as
Atlanta, Dallas, and Richmond, otherwise robust activity is being hampered by wet weather.
Sales of new and existing homes are reportedly strong in most districts, and modest price
appreciation is noted by many districts.

Commercial real estate markets are uniformly described as strong by reporting districts.
Contacts in a number of districts are reporting declining vacancy rates, rising rental rates and
increasing speculative construction. The commercial real estate market has “picked up
dramatically” in the Richmond district, with “floods of tenants looking for space.”
Nonresidential construction and prices are up in California, while the Dallas district reports a
sharp increase in land prices. Contacts in several other districts, however, see signs of an
impending slowdown and are worried about the pace of speculative building.

**Banking and Finance**

Most districts report moderate to vigorous demand for bank loans. Contacts in the Chicago, Cleveland, Dallas, Minneapolis, Philadelphia and San Francisco districts indicate that loan competition, especially on the commercial side, is stiff, although there are concerns in some districts that this competition could compromise credit standards. Mortgage lending, especially refinancings, is reportedly strong in the Atlanta, Chicago, Cleveland, Dallas, Kansas City, New York, Philadelphia, Richmond and St. Louis districts. Contacts in the Atlanta and Chicago districts report robust consumer loan demand, while contacts in the Cleveland, Dallas, Philadelphia and St. Louis districts note some softening. A reduction in consumer loan delinquencies is reported in the Chicago and New York districts. The Chicago district notes that credit card repayments are up and personal bankruptcies are declining.

**Agriculture and Natural Resources**

Agricultural conditions vary widely across districts. The deluge of rain that hit California has damaged crops. Near-record precipitation has reportedly worsened the condition of the winter wheat crop in the Richmond district rather significantly. In the Kansas City district, however, the winter wheat crop appears to be in good shape. Although rains have delayed field activities in the Dallas and Minneapolis districts, overall conditions are reportedly good in those areas. Contacts in the Richmond district are worried that a late frost may harm the apple and peach crops. The Chicago district reports that corn exports have weakened markedly—not solely because of Asia—although the soybean export picture is somewhat brighter. In the St. Louis district, cotton exports to Asia, while still expected to wane, are not declining as much as many had expected since sales to other markets, such as Mexico, have picked up. The San Francisco
district reports a similar situation for beef and pork exports. Lower cattle and hog prices are hurting the profit margins of producers in the Chicago, Minneapolis and Kansas City districts.

The unseasonably warm winter weather has affected the energy extraction industries to varying degrees. The Dallas and Minneapolis districts report increased activity, while energy output increases have begun to decline in the Kansas City district. Solid demand for steel continues to bolster iron ore output in the Minneapolis district.
The First District economy continues to expand. Retail activity has picked up recently in many sectors. Manufacturers’ results are mixed, with some contacts experiencing accelerating revenue growth and about half seeing no increase in sales or orders from a year ago. Many respondents report hiring difficulties, and contacts in the temporary employment industry say their revenues are expanding at double-digit rates. Prices are said to be generally steady. Residential real estate markets are doing well.

Retail and Tourism

Most retail contacts report that sales are growing at a healthy pace, with the growth rate higher now than in the second half of 1997. This unexpected strength in sales is not causing upward revisions of 1998 growth projections, already strong at 4 to 7 percent. Faster-growing sectors are office and graphics supplies, tourism, consumer electronics, home furnishings, building materials, and health and beauty aids. Areas of weakness are hardware, automotive parts, and apparel.

Employment is said to be either increasing moderately or holding steady. Half the contacts report tightness in labor markets and corresponding difficulty finding, attracting, and retaining employees. Shortages are reportedly concentrated in high-skill areas; low-skill retail help is ample except in selected small geographic pockets. In most sectors, wage growth has picked up somewhat and is now running at a 4 to 6 percent annual rate. By contrast, in sectors growing only moderately, wages are said to be increasing only 2 to 3 percent.

With one exception, respondents say that prices are holding steady. The exception is tourism, where a continuing shortage of hotel rooms in the Boston area is causing room rates to rise. Vendor prices are also holding steady or, in some cases (lumber and fuel), declining dramatically. Profit margins are increasing slightly. Except for “aggressive expansion” in the tourism sector, contacts indicate they plan to expand capital budgets modestly in 1998.
Manufacturing

About one-half of First District manufacturing contacts report that recent business is up from a year ago, with strong and/or accelerating growth for aircraft and heavy truck parts, furniture, and equipment servicing. The remaining firms mostly report that overall sales or orders are steady from a year ago. Some exporters report sharp declines in Asian revenues, while others expect that a slowdown will become noticeable by mid-year. Several respondents express concern that the strong dollar is impeding export growth generally, even beyond Asia.

Manufacturers indicate that most materials costs are flat to down compared to a year ago. They cite reduced prices for copper and oil in particular, as well as greater bargains on components from Asia. Contacts mention that furniture materials costs are rising, however, along with travel costs. Selling prices are largely stable because of flat to declining supply prices, improved production efficiencies, competitive pressures, and retailer resistance. One maker of machine tools recently implemented a price increase, although another lamented that industry prices are far below normal levels because of intense global competition. Computer prices are falling sharply.

Employment trends vary widely among the manufacturers contacted, with roughly one-third implementing layoffs, one-third hiring at double-digit annual rates, and the remaining one-third somewhere in between. Almost all respondents report some hiring difficulties, usually for selected high-skill jobs. Most contacts indicate that average pay is rising 3 to 5 percent. Firms differ in the degree to which they are adjusting compensation packages to deal with labor shortages. In addition, one-half of those facing labor shortages are outsourcing more work and one-quarter report passing up some business opportunities.

Temporary Employment Firms

Temporary employment firms in the First District continue to expand at a brisk pace. Labor markets are said to be extremely tight across all client industries and First District locations; wage growth for temps has reportedly risen to 15 percent annually. Demand continues to far outpace supply for more highly skilled
workers, from computer programmers to clerical workers with knowledge of multiple software packages. Contacts foresee continued double-digit growth in revenues over the next year.

Residential Real Estate

The residential real estate market in New England is strong. Most contacts report active markets and more sales than last year. Activity has risen most markedly in Massachusetts and New Hampshire. The number of sales increased also in Connecticut and Rhode Island, while the number of sales in Maine was stable until February, when it rose markedly. Increased activity has not generated price increases except in New Hampshire and Massachusetts, where high demand and extremely low inventory levels have caused prices to rise 4 to 9 percent from a year ago. Mild winter weather has allowed Massachusetts builders to work at full capacity during the past few months, and some spec construction is being undertaken. Contacts in other states report that it is still a “buyers’ market,” although the level of inventory is shrinking and price increases are expected later this year. Contacts are optimistic, however, and stated that unless interest rates go up, the market will remain strong for the next few months.

Nonbank Financial Institutions

Nationwide cash flows into stock and bond mutual funds were 23 percent higher in January 1998 than in December of 1997. Stock funds experienced moderate outflows which were more than offset by the doubling of inflows into bond funds. The largest inflows were into high yield bond funds, while international stock funds experienced their fourth consecutive month of outflows.

Respondents at investment management firms indicate that they have increased employment in recent months and plan to increase employment further, although these increases have been hampered by labor shortages. All respondents report significant difficulty hiring and retaining information technology personnel. Most contacts are implementing targeted wage increases and hiring bonuses for workers in short supply; many are also broadening their recruitment techniques.
SECOND DISTRICT--NEW YORK

The Second District's economy continued to grow briskly in the first two months of 1998. Retailers report that sales were above plan in February, while both selling prices and merchandise costs held steady. The housing market retained momentum in early 1998, following a strong fourth quarter. Commercial rents across most of the metropolitan area have risen rapidly in recent months, as office vacancy rates continued to fall. Regional purchasing managers report a pickup in activity, reduced price pressures for manufacturing inputs, but an acceleration in some labor costs. Finally, local banks report a pickup in loan demand, and a continued modest decline in consumer delinquency rates.

Consumer Spending

Retailers report that sales were generally on plan in January but above plan in February. Same-store sales for the two months, compared to a year earlier, varied widely—from no gain to a 10 percent increase. In general, those retailers with weak sales attributed the softness to unusually mild winter weather. Those with strong February sales noted that virtually all categories performed well, especially furnishings, appliances and women's apparel. Most retailers report that inventories are in good shape. Overall, it appears that discounters continue to fare slightly better than traditional department stores.

Retail selling prices and merchandise costs were said to be mostly flat, and no increases in wage pressures were reported. Most contacts expect only a modest reduction in merchandise costs as a result of the Asian currency crisis, though one major retailer anticipates “significant savings.” All expect to pass along any cost savings to customers in the form of price reductions; these lower-cost products may start to show up on the shelves as early as July, but mostly after Labor Day.

Construction & Real Estate

The region's housing market continued to strengthen in early 1998. New Jersey homebuilders report that new home sales were brisk in February—especially at the high end of the market, where
nearly all of the buyers are in the securities industry, as opposed to the usual broad mix of high-level executives. Aside from large Wall Street bonuses, strong market conditions in early 1998 are attributed to mild winter weather, low but rising mortgage rates, and increased consumer confidence. One contact notes that with the supply overhang from the early 1990s now mostly gone, a tight market for single-family homes is “finally” spilling over into the new home market. Home remodeling also remains brisk.

New York State realtors report that existing-home sales were steady in January, running 4-5 percent ahead of a year ago. Prices retreated a bit from lofty December levels, but were still ahead of a year ago by about 4 percent. In general, upstate New York has registered increased volume and steady prices, while downstate has had the reverse. Following a fourth-quarter surge, prices of prime Manhattan co-ops and condos held steady at exceptionally high levels in January, according to a major broker. The average price per room continues to run more than 20 percent higher than a year ago.

Office markets across the New York City area continued to tighten in late 1997 and early 1998. Midtown Manhattan’s office availability rate (space coming available in the next six months) edged down from 9.1 percent at year end to 8.9 percent at the end of January; similarly, Downtown’s rate slipped from 15.5 to 15.2 percent. Midtown rents continued to rise rapidly in January, running 8 percent above year-ago levels; Downtown rents have risen a more moderate 4 percent.

Markets also continued to tighten in the rest of the NYC area, where figures are tallied quarterly. Long Island’s vacancy rate tumbled nearly 3 percentage points during the fourth quarter, ending 1997 at an all-time low of 10.6 percent. Vacancy rates fell by roughly a full point in northern New Jersey, Westchester, and Fairfield. In the final quarter of 1997, office rents continued to rise at their trend pace of 6 percent in New Jersey but surged at a double-digit rate in Long Island, Westchester, and Fairfield.

**Other Business Activity**

Regional purchasing managers report a pickup in activity in February. Buffalo purchasing
managers report that production activity grew at a slower pace in February than January, while commodity prices were steady. However, new orders rose sharply in February, as did hiring activity. New York purchasing managers report that manufacturing activity rebounded sharply in February, while non-manufacturing experienced a more moderate pickup. Prices paid by manufacturers dipped in February but non-manufacturing costs rose sharply, led mainly by labor costs—specifically, computer consultants, temps and construction services.

Separately, contacts in various sectors note tight labor market conditions, especially for computer experts, as well as for office support with modest technical abilities. One contact at a leading NYC-area employment agency remarked that “the region's labor market has never been hotter,” adding that increased flexibility and efficiency in the labor market are helping to keep a lid on wage inflation.

In New York City, tourism remained fairly robust during the usually slow month of January—hotel occupancy rates (seasonally adjusted) held steady at close to 85 percent, while room rates eased slightly. The local industry expects to get a slight boost from a 23 percent hike in travel stipends for Federal employees traveling to NYC effective January 1. In western New York, Buffalo convention bookings set a new record in 1997 and look to be even stronger this year, while Niagara Falls reports a sharp increase in conventions booked for 1998 versus 1997.

Financial Developments

Bankers at small to medium-sized banks in the District report stronger demand for loans during the past two months. Demand for residential mortgages strengthened most notably, with 75 percent of bankers reporting increased demand. Refinancing activity for all types of loans increased. Willingness to lend increased slightly, while credit standards remained stable across all loan categories. Deposit rates fell moderately, while lending rates fell sharply across all categories. Delinquency rates declined for consumer loans, but remained stable for mortgages and commercial and industrial loans.
THIRD DISTRICT - PHILADELPHIA

Business conditions in the Third District in February and early March were mixed but positive overall. Manufacturers reported continued increases in shipments and orders. Retailers said sales were moving up, but auto dealers said sales had eased. Bankers reported some slowing in overall loan demand as lending to individuals declined, but they were generally posting gains in real estate and business lending. Both commercial and residential real estate markets were described as healthy by real estate agents and home builders. Commercial construction was said to be increasing, and residential construction was characterized as steady at a fairly strong rate. Contacts in the retail and real estate sectors cited mild weather as a boost to current activity, but fundamental conditions were also considered to be good, and further gains are anticipated in the spring.

MANUFACTURING

Manufacturers reported continued improvement in business in February compared to January. Shipments were up at one-third of the firms surveyed, and four out of ten said new orders had increased, twice the number reporting decreases. Firms in nearly all major industry sectors reported improvement; however, several companies commented that orders from Asian customers were declining. The industries most affected were machinery, chemicals, and high-technology products.

On balance, Third District manufacturers boosted employment in February. Around 20 percent of the firms contacted added jobs in the month; 75 percent held employment steady. Industries with employment increases were textiles, machinery, transportation equipment, and
instruments. Employment eased among food processors and producers of primary metals. In other industries, mainly consumer goods manufacturing, employment was steady.

Industrial prices in the region remain nearly steady. More than three-fourths of the manufacturers contacted for this report said the prices of the goods they buy were unchanged from January to February, and nine-tenths said the prices they charge for their products have been level. Some firms said prices of the commodities they use have fallen recently, reducing their input costs, and several firms noted they were installing new equipment to increase production efficiency and reduce operating costs in order to keep output prices competitive.

RETAIL

Retail sales in the Third District have been moving up since the start of the year, according to merchants polled in early March. Based on these retailers’ comments, sales in the region have been running approximately 4 percent above last year’s pace, on a current dollar basis. Store executives believe mild weather boosted sales in January and February, but they said the usual spring pickup, especially in sales of apparel, appeared to be occurring in early March.

Auto dealers generally reported a slowdown in sales during February and an increase in inventories except for some popular models. Sales of both cars and light trucks have eased from January’s rate. Despite the current slowdown, most of the dealers contacted expect sales to improve this spring.

FINANCE

Most of the Third District banks contacted for this report indicated that their loan volumes outstanding were falling slightly. In recent weeks, real estate lending and lending to
businesses have been increasing, but consumer lending has been declining. Both residential and commercial real estate lending were moving up at the region's financial institutions. Bankers noted increases in purchase mortgages and home equity loans. Although commercial real estate lending has increased, bankers said they were becoming increasingly selective, turning down prospective borrowers who have requested loans of higher amounts in relation to property values than has been the norm recently. Banks are actively soliciting new commercial and industrial loans, especially among middle market firms.

Much of the slowdown in consumer lending has been in auto financing. Banks have been cautious in lease financing in response to declining residual values. According to some reports, auto manufacturers' finance subsidiaries have taken more of the lease financing business.

REAL ESTATE AND CONSTRUCTION

Commercial real estate agents reported that office vacancy rates declined from the third quarter to the fourth quarter of 1997 and rents rose. According to recent surveys by commercial real estate companies in the region, office vacancy rates dropped around 1 percentage point during the last quarter of 1997 to around 14 percent in central Philadelphia and 10 percent, on average, in suburban markets. Vacancy rates for Class A buildings were lower, but real estate agents said vacancy rates for less than Class A buildings were significantly higher and rents were lower. Demand for industrial space, primarily distribution facilities, remained high. Some speculative construction of offices and industrial buildings was under way in the region. Commercial realtors generally agreed that current rents and vacancy rates justify construction of more buildings, but some were concerned that an oversupply of space could develop if economic growth in the region eases.
Residential realtors and home builders said sales of existing and new homes have been steady in the past month at fairly high levels. There has been some price appreciation for existing homes and increased demand for higher-priced new homes, although both realtors and builders said price increases have not been great. Realtors said some of the strength in home sales this winter, compared to last year, has been due to the mild weather, but they added that healthy employment conditions and the rising stock market have boosted buyers' willingness to make home purchases.
Fourth District - Cleveland

General Business Conditions

The Fourth District economy continues to grow, but at a moderating pace. Labor markets are strong and price pressures remain light. Both residential and commercial construction are flourishing, particularly in the central Ohio and Pittsburgh areas.

Temporary employment agencies report increased demand since the beginning of the year, especially for data entry employees and administrative assistants. Historically, the first quarter is a slack season, so the robust activity thus far in 1998 suggests that temporary employment demand for the rest of 1998 will exceed even the high levels seen in 1997.

Many companies report that they are increasingly willing to train unskilled employees, especially those who are willing to learn some computer skills. Some also mention a shift in the composition of those seeking work, resulting in relatively greater numbers of younger (19-21 years), older (65 and over), and less educated (those with only a high school diploma) applicants.

Organized labor reports a small increase in annual wage growth to slightly over 3% per year. Those unions that have not yet seen wage gains expect to see them in the near future. The main focus of current contract negotiations is wages, which the unions are targeting in preference to job security issues. Benefits growth is said to be stagnant, while the trend toward longer contracts has continued into the first part of 1998.
Manufacturing

Industrial activity remains strong. Most manufacturers report an increase in production levels, but the number of those reporting production declines has risen a bit. New orders have increased, but not at the rate experienced in January.

Steel producers report strong growth in orders, but stable raw materials prices have held the product price down. The demand from the auto industry is so strong that some producers report shipping their steel while it is still hot. Asian developments have not had a strong effect on final sales due to healthy domestic demand and long contract lead times associated with exports of higher-performance steel.

Consumer Spending

Most retailers expect 1998 to be a stronger year than 1997. Retail sales in the District have met or slightly exceeded expectations for the first part of the year, with January sales significantly above target but February sales only marginally so. Gains appear to have been led by strong demand for apparel and wireless communication. There is a wide disparity in reported inventory levels, but the average seems to be slightly above the desired levels.

January and February auto sales showed strength in the minivan, sport utility vehicle, and truck categories, but were flat for passenger cars. As a result of heavy inventory buildup in the slow months leading to the holidays, dealers have an ample supply of cars. There is some downward price pressure in the used vehicle market because large numbers of 1996 models are being returned from lease agreements. However, leasing prices are marginally higher as a result of lower residual values.
Transportation

Trucking has benefited from the strong market in structural steel. Generally, however, business in trucking remains only somewhat better than at this time last year. The air cargo business has seen steady, if unspectacular, growth since the beginning of the year, particularly for machine parts and international shipments.

Coal

Eastern Kentucky coal mines expanded output in 1997 by 2.3%, only slightly less than the U.S. average increase of 2.9%. Coal production is expected to remain high this year, despite increased foreign competition for the lucrative export markets in steam coal. Serious concern was expressed about the potential regulatory impact of the Global Warming Treaty. Producers are particularly worried that provisions of the treaty might make Kentucky coal production more expensive and harm its competitive position. On the labor front, the collective bargaining agreement between the United Mine Workers and the Bituminous Coal Operators Association, which was set to expire this year, has already been renewed.

Banking and Finance

Lending activity in the District remains vigorous, with commercial loan demand continuing to strengthen. Consumer loan demand has weakened slightly, but mortgage refinancing remains very robust. Consumer loan delinquencies are edging up slightly, although commercial delinquencies remain low. The narrow spread between borrowing and lending rates is resulting in significant interbank competition and small profit margins, and there is mild concern that banks may be easing consumer credit standards somewhat.
Overview: The Fifth District economy expanded at a somewhat faster clip in recent weeks despite weather-related slowdowns in some sectors. Consumers continued to spend freely, with retail sales growth outpacing that of a year ago. In addition, manufacturers reported that orders and shipments rebounded sharply from an early winter slumber. Real estate activity, both in the residential and commercial sectors, picked up considerably, although residential builders noted that excessive rainfall reduced housing starts somewhat. Unusually wet weather also kept tourists away from coastal resorts and farmers out of their fields. In the service sector, growth remained healthy, even though the overall pace was held back by a reduction in utilities' sales. Shortages of both skilled and entry-level workers worsened, and reports of higher wages were more widespread. Prices, especially in the service sector, increased at a somewhat faster rate.

Retail: Since the beginning of the year, the retail sector has hardly missed a beat. January sales held up better than in past years, and most merchants told us they were pleasantly surprised by the strength of consumer spending in February. Mild temperatures hurt winter apparel sales, but got spring clothing off to a fast start. Consumers' purchases of durable goods strengthened. Sales of both new and used automobiles exceeded dealers' expectations, and furniture retailers reported that their businesses were finally benefiting from buoyant housing markets. While maintaining sales growth remained a priority, many merchants told us that their biggest concern was finding and retaining workers. One said that the lack of available workers "was keeping [him] awake at night." Reports of wage increases were more prominent than in our last report. Retailers indicated that prices generally increased at a faster rate in recent weeks. Restauranteurs and general merchandisers reported the largest price increases; apparel retailers, however, continued to report widespread price discounting.

Services: District service producers experienced healthy growth in recent weeks. Businesses associated with real estate—including mortgage insurance companies, real estate brokers, and appraisers—noted particularly strong revenue growth, as did both passenger and
freight airlines. Electric utilities and natural gas suppliers, on the other hand, reported decreased revenues as unseasonably mild temperatures reduced energy demand. Service sector employment growth slowed amid widespread complaints of shortages of qualified workers. Service contacts reported faster price growth since our last report; the pick-up was most evident in the business services, finance, real estate, and lodging sectors.

**Manufacturing:** Since our last report, District manufacturers witnessed a resurgence in activity. Overall shipments and new orders rebounded sharply, even though producers of transportation equipment and industrial machinery reported disappointing growth. Most manufacturers continued to indicate that their sales had not been impacted by the financial crisis in Asia. An exception was a textile producer who suggested that a recent “flood” of Asian imports had hurt his industry. While a Virginia port representative stated that Asian difficulties had “hindered textile exports,” contacts at other ports noted little impact on either exports or imports. Manufacturers continued to add employees, but many expressed growing concern over the quality of their job applicants. Wages grew somewhat faster than in our last report.

**Finance:** Lending activity increased in January and February. Mortgage lending—both new originations and refinancings—was particularly brisk; a Charlottesville, Virginia banker said that “January was pandemonium” in her office because interest rates were so low. Commercial lending also rose, boosted in part by increased business merger and acquisition activity. Banks’ credit standards changed little since our last report.

**Real Estate:** Low interest rates and higher consumer confidence sparked real estate sales in recent weeks, but wet weather hampered homebuilding activity. A Virginia contact reported "booming" home sales while a South Carolina realtor said that it was the "best January and February ever" in his area. A number of realtors attributed higher sales to an influx of new businesses coming to their areas. Frequent rains across most of the District, however, thwarted contractors’ efforts to keep apace of demand. Nevertheless, builders reported that the rains didn’t diminish their optimism or affect the number of building permits being sought.
Commercial real estate activity picked up dramatically, with one contact noting that "floods of tenants were looking for space." The continued strength surprised some contractors who had "expected the market to hit saturation by now." Projects underway in the District included small office buildings and larger industrial warehouses as well as retail establishments, a growing portion of which were speculative buildings.

**Tourism:** Contacts reported that the unseasonably warm, wet weather of recent weeks had a mixed impact on District tourist activity. Despite mild temperatures which hindered snowmaking, attendance at ski resorts was near all-time highs. One contact said that the addition of a snow tubing park had increased his resort's customer base by appealing to those who do not ski. The warmer temperatures, however, caused ardent skiers to travel further in search of natural snow, benefiting West Virginia ski resorts. Frequent rains dashed hopes of a second year of record-breaking winter tourist activity at coastal resorts.

**Labor Markets:** Employers continued to experience difficulties finding qualified workers to fill vacant positions. A number of temporary agencies said that their greatest challenge was finding "trainable" people for entry-level production and customer service positions. One contact said that, increasingly, businesses were hiring two or more college students on a part-time basis to fill each full-time vacancy. While overall wage increases remained modest, workers with highly sought skills were "calling the shots" in their wage negotiations.

**Agriculture:** Near-record rainfall in many areas had mixed impacts on small grain crops. Wet and muddy fields barred farmers from applying fertilizer to the winter wheat and barley crops and from starting their pre-planting tillage. Standing water in low-lying fields was common, and one agricultural analyst said that flooded fields could reduce winter wheat yields in his area by as much as 20 percent. Elsewhere, the rains and milder-than-normal temperatures apparently benefited small grain crops. Analysts said that fruit trees budded early, increasing the risk of spring frost damage to peach and apple crops.
VI-1

SIXTH DISTRICT – ATLANTA

**Summary:** Southeastern economic activity continues to expand at a moderate pace, according to business contacts. Merchants report that sales have met their expectations, which were above levels of a year ago. Home sales have been boosted by low mortgage interest rates, but weather problems have limited building in some parts of the region. Nonresidential construction spending remains healthy, with new speculative building underway. Factory activity is mixed, with weakness in some sectors balanced by strength in others. The tourism and hospitality industry continues to post impressive numbers. Consumer and commercial loan demand is growing moderately. Contacts expressed concern over labor shortages for skilled and unskilled workers; however, reports of escalating wages are infrequent. Overall, prices remain stable.

**Consumer Spending:** According to retail contacts from across the District, retail sales were up year-over-year in both January and February; however, February sales were slightly weaker than January’s. Most retailers agreed that recent sales had met their expectations, and inventories are in good shape. Apparel continues to be a strong seller. Sales during the first quarter are expected to exceed last year’s sales slightly.

**Construction:** Reports from real estate contacts indicate that both new and existing home sales were stronger in February than a year ago. These contacts say low mortgage rates are boosting sales in most areas of the region. Home construction activity has been subdued in some parts of the District because of inclement weather. However, inventories remain generally in balance. Several contacts noted that lower priced or starter homes are the strong sellers in their market. Looking forward, a slight majority of builders expect new home construction will be up compared with last year in the first and second quarters; most real estate agents agree.
Commercial real estate markets remain healthy throughout the region. Most suburban and central business district office markets are recording rising occupancy rates and rentals, and a considerable amount of speculative office construction is underway. The industrial sector has begun to show some signs of slowdown, as new supply and vacancy rates move up in several markets. Retail markets remain healthy across most of the region. Overall, both developers and real estate agents’ outlooks remain optimistic for the year.

**Manufacturing:** Factory activity varied by industry. Contacts note further slowing in the region’s apparel sector, with the closure of one large plant and declining orders for others. A few small apparel companies that have found a market “niche” are reportedly doing well. Some contacts note that apparel companies are feeling negative “Asian effects,” with slower sales to foreign markets. More positively, the outlook has improved for a plywood producer and a manufacturer of building products that experienced the factory workweek and shipments weakness not long ago. In Louisiana, oil field projects are maintaining a steady pace, and there is an overall optimistic outlook for the industry. Chemical producers are reportedly more concerned with the regulatory climate than that of the Asian situation, as many plant expansions are underway.

**Tourism and Business Travel:** The tourism and hospitality industry remains robust, according to most contacts. Theme park expansions, along with a number of hotels currently under construction, or in the planning stages, are indicators of the positive outlook for central Florida’s tourist industry. Although the weather in the Northeast has been unusually warm, south Florida contacts report that March bookings have been strong. Louisiana’s Department of Tourism expects 1998 to be another good year and is stepping up encouragement of foreign airlines to expand flights
into the state. Revenues for Mississippi’s tourism and hospitality industry rose substantially in 1997, and the state’s tourism and hospitality official reports double-digit increases in inquiries.

**Financial:** Banking contacts report that loan demand has been expanding moderately throughout the Sixth District. Consumer and commercial loan demand are growing, and mortgage-refinancing activity continues to be brisk. Auto loan demand remains healthy, especially in the luxury car segment.

**Wages and Prices:** Wage pressures remained constrained, according to most contacts, but labor shortages are a cause for concern. Along the Mississippi Gulf Coast, job fairs in casinos and department stores are becoming frequent in order to help ease labor shortages. Employers in Louisiana’s shipbuilding industry are frustrated by their inability to find qualified workers. In Tennessee, technical centers have contracted with several industries and are beginning apprenticeship programs to help provide a continuing supply of skilled workers. Contacts also say that workers skilled in the construction trades are in demand as are general laborers. The majority of retail merchants report that labor costs have risen between zero and 4 percent, year-over-year.

Prices remain mostly stable as businesses struggle to keep costs down. Some contacts report that improved productivity from computers and high-tech goods are helping employers to hold the line on price increases. Some firms are pushing for lower benefits for workers as a result of rising benefit and medical costs. One contact reports that the “Asian crisis” is benefiting his suppliers by allowing them to make purchases at significantly reduced prices, although others note that multi-year pricing agreements are keeping costs stable.
Summary. The Seventh District’s economic expansion picked up modestly in January and February, led by increases in consumer spending and housing activity. Some contacts, however, suggested that the unseasonable strength in retailing and housing early in the first quarter may be borrowing from later in the year. Manufacturers continued to operate near capacity and strong new orders showed no signs of softening. Lending activity picked up as many consumers refinanced their existing mortgages. Overall wage pressures remained generally subdued despite very tight labor markets and worker shortages in some occupations and industries. Credit guarantees cushioned any Asian impact on crop exports this winter, but low livestock prices triggered heavy operating losses for many District farmers.

Consumer spending. Most District retailers were quite satisfied with sales results in January and February. Sales were generally described as above expectations and most merchants indicated that this strength was broad-based. Unseasonably warm weather in the early part of 1998 increased traffic through most stores and greatly boosted sales of spring items, as well as some other goods. Spring apparel sales were doing very well with women’s lines particularly strong. Some motorcycle dealers in the region credited the effects of El Nino for record high sales in January and February, at levels far above their seasonal averages. Exceptionally strong housing markets boosted the sales of complimentary items, such as furniture, home decor, appliances, electronics, and household tools. In addition, the spurt in mortgage refinancing activity improved consumers’ debt positions, which some merchants credited with increasing sales of household and home improvement items. Inventories were in good shape, allowing most retailers to limit their use of promotional activities and concentrate on profit margins.

Housing/construction. Overall construction activity picked up moderately in January and February, led by a sharp rebound in new housing construction. A healthy economy, low mortgage interest rates, and very mild winter weather were frequently cited by contacts as factors contributing to an unseasonably strong new home market. Most builders described sales as exceptional for this time of the year, with one adding “if builders aren’t selling now, they never will!” The strength appeared to be broad-based across both geographic and market segments. Some builders felt that strong sales this early in the year may lead to a slower-than-normal spring rush. This would not be entirely unwelcome to builders, given some of the labor shortages and
materials bottlenecks that have occurred periodically over the last few years. Sales of existing homes continued to surprise on the upside, with most realtors reporting early 1998 sales results that were near record levels for this time of year. Broad-based strength in commercial construction activity was also reported, but contacts indicated that growth may be slowing in some segments.

**Manufacturing.** Manufacturing activity remained robust in the District with virtually every sector running near capacity. Contacts in the heavy truck industry indicated that demand was high and production was running "full tilt," with only capacity constraints restraining stronger growth. The heavy/agricultural equipment and steel industries experienced similar strength, with orders booked through the second quarter and plants operating near capacity. One large steel producer reported having to turn new orders away. Output of light vehicles remained very healthy in the region amid continued reports of strong sales. There was some concern that momentum in the industry was being buoyed by discounting, with one contact noting that incentives were at levels normally reserved for the end of the model year. Inventory levels for most manufacturers were in good shape, although they were slightly low for producers of heavy and agricultural equipment and slightly high in the auto industry. Prices for raw materials continued to show very little movement as did product prices. Steel producers were successful in pushing through very modest increases, but prices were still below 1994 levels. A producer of supplies to the construction industry also raised prices, but only expected to reap half the announced increase. Adverse effects from East Asia's turmoil remained generally concentrated in the heavy/agricultural equipment sector. There were no reports of these effects spreading or worsening.

**Banking/finance.** Business lending activity was strong throughout the District and the consumer segment showed signs of gaining momentum. The unseasonably warm weather and low interest rates boosted housing activity and, as a result, mortgage originations. The exceptional activity, however, was in the refinance market. Every banker contacted reported that refinancing activity was up sharply in January and February, with one stating that activity was like nothing he's ever seen before. Reports indicated that personal delinquencies, repayments on credit cards, and bankruptcies were improving. On the commercial side, loan activity remained brisk, but loan growth appeared to be slowing. Overall asset quality was generally described as good, and improving slightly on the consumer side. Some bankers expressed concern that fierce competition in the commercial segments may have slightly eroded asset quality. Continuing a trend noted in
our last report, additional contacts indicated that Asian lenders were withdrawing from U.S. lending markets as a result of the “Asian Contagion” turmoil.

**Labor markets.** In January and February, conditions in the District’s labor markets changed little from late last year. While unemployment rates remained very low and shortages persisted in some industries and occupations, wage pressures were relatively unchanged. Construction help and information technology workers were most frequently cited as being in short supply. Entry-level positions continued to be difficult to fill and one contact indicated that this was due, in large part, to skill-matching problems. Most businesses indicated that growth in base salaries remained relatively subdued (with the exception of occupations in short supply, where wage increases were more pronounced), while the use of bonuses and other “one-time” incentives increased. One analyst noted that businesses were becoming ever more creative in their recruiting efforts, with at least one firm offering modest weekend trips as an incentive. The employment component of purchasing managers’ surveys from throughout the District all showed sharp increases from January to February as well as in year-over-year comparisons. The same trend was evident in indexes derived from the volume of help-wanted advertising in local newspapers and quarterly hiring plans surveys. One contact cited very tight labor markets in Iowa as impeding economic growth in the state, and a regional manufacturer indicated that increased use of overtime was cutting into the company’s profit margins.

**Agriculture.** Corn export prospects remain depressed. As of late February, corn export commitments (shipments-to-date plus outstanding orders) for shipment in the year ending with August were down one-fourth from a year ago. Ironically, however, the decline in corn export commitments to all Asian markets was no worse than that for all other destinations. Late-February soybean export commitments were nominally above the year-ago level, but somewhat weaker for Asian markets than elsewhere. Export credit guarantee programs offered by the U.S. Department of Agriculture to hard-hit Asian countries helped sustain new corn and soybean commitments to those markets during January and February. District livestock farmers experienced extensive operating losses this winter. Large meat supplies and weak demand, for both domestic consumption and exports, depressed cattle and hog prices. The losses for pork producers are likely to continue for several months.
Summary

The District economy continues to generate stable business growth coupled with few signs of rising consumer prices. Retail sales growth met most contacts’ expectations, and they anticipate stronger growth this spring. District manufacturing firms are experiencing growth in sales and new orders, while continuing to cope with tight labor markets and moderate wage pressures. A Manpower survey of District firms shows the pace of hiring picking up in the second quarter compared with the first quarter. Unseasonably mild winter conditions supported higher than usual levels of residential and commercial construction and real estate sales in most parts of the District. Loans outstanding at large District banks rose 2.4 percent in the first two months of 1998, compared with a 0.8 percent decline in the same period a year ago. The Asian situation is not yet pulling down cotton exports to the degree that many District producers expect.

Consumer Spending

Retailers report that January sales were up about 4 percent over the previous year—a pace that met contacts’ expectations. Sales of winter clothes have been very slow due to mild winter weather, while sales of home furnishings have picked up in anticipation of an early spring. Although most contacts report that current inventories are at desired levels, several noted that their inventories are slightly high. Retailers are anticipating a moderate increase in sales growth in the second quarter. Sales in Missouri may be boosted by the recent refund of state budget surpluses; these refunds averaged $300 per household.

Automobile dealers report that sales in January were down an average of 12 percent to 15 percent over the previous year. Several speculated that high levels of consumer debt kept buyers
away. More than half of the contacts have been using rebates and incentives more than usual to move stock. In addition, nearly half of the respondents indicate that their current inventories are too high. Dealers remain optimistic, though, that sales will pick up in the second quarter.

**Manufacturing and Other Business Activity**

Overall, District contacts report that business conditions remain favorable, and that growth in sales and new orders continues to chug along at a moderate pace. Contacts also report that competitive markets and productivity improvements are keeping price increases at bay, even though input costs continue to increase modestly. Tight labor markets continue to plague District firms. Contacts in Kentucky are concerned that UPS will have a difficult time finding the 6,000 workers or so it will need as part of a just-announced $860 million expansion in Louisville.

Contacts from a variety of District industries report growth in sales and orders. A contact in the furniture industry, for example, reports that industry sales have been high and growing modestly recently. That said, some smaller furniture manufacturers aren't faring well compared with their larger competitors. District auto plants are stepping up production of pickup trucks and sport utility vehicles, and a tire producer is considering going to seven day (from six), 24-hour shifts to keep up with demand. To cut costs, however, a maker of home appliances will shift production from Kentucky to plants in Georgia and Mexico. In anticipation of costly settlements or lawsuits, tobacco firms are cutting back on workers to preserve profits.

**Employment Outlook**

According to Manpower's second-quarter employment outlook survey, the pace of hiring will pick up in Little Rock, Louisville and Memphis relative to the first quarter. Gains are expected to be most pronounced in Little Rock, where about half of surveyed firms intend to boost their payrolls. In St. Louis, by contrast, little change in second-quarter hiring is expected. Compared with a year
earlier, though, considerably less hiring is expected, with only Memphis firms anticipating higher employment levels.

**Real Estate and Construction**

Mild winter conditions led to unseasonably high levels of residential building construction in most parts of the District in January. In almost all of the District’s 12 metropolitan areas, monthly and year-over-year building permits were up. Sales of new and existing homes also were unseasonably high, with most contacts reporting moderate increases in average selling prices. Commercial construction—dominated by office, retail and apartment—is also strong in many parts of the District. Some contacts are concerned, however, that apartment construction might be too aggressive in some areas, given the expected demand.

**Banking and Finance**

Total loans on the books of a sample of large District banks have increased 2.4 percent since the start of the year. One year ago, total loans declined 0.8 percent over the same period. Commercial and industrial loans have risen 1.3 percent, while real estate loans have increased 3.3 percent. Consumer loans have declined 1.8 percent over the period.

**Agriculture and Natural Resources**

Cotton industry contacts report that the Asian situation has not yet affected export quantities to the degree anticipated a few months back; the largest effect, they believe, has been on prices. Although exports to certain Asian markets have been reduced, the drop in cotton prices has spurred additional sales to other markets, such as Mexico and Turkey. Overall, cotton producers still expect some reduction in exports to Asia, although not to the extent anticipated three months ago. A cotton industry report suggests that cotton plantings this spring could be the lowest in 15 years.
NINTH DISTRICT--MINNEAPOLIS

On balance the Ninth District economy continues to show steady to strong growth in most sectors. But overall strength and booming urban areas are shaded slightly by slowing in nonurban areas of the district due to adverse weather and declining commodity prices.

Most sectors and households continue to enjoy a very strong economy. Construction and manufacturing are striding workhorses that continue to provide impetus to the economy as a whole. Retail sales of general merchandise are very strong. Oil and iron ore production levels are at decade highs. Banks reportedly have good loan volumes in a competitive environment. Unemployment is low and price pressures are scarce.

But declining prices for hogs, corn and soybeans combined with already low wheat prices and concerns about moisture availability have sharply curtailed farm profitability and optimism for the new year. Warm weather and poor snow cover hurt revenues for many winter recreation firms. Many businesses are cramped by labor shortages.

Manufacturing and business services
Manufacturers generally report good orders. Medical electronics and devices continue strong in Minnesota. Machining, metal finishing, electronic instrumentation, printing, metal tubing and other firms in Minnesota, Wisconsin and South Dakota also report good business. North Dakota firms producing specialized mining machinery and wiring harnesses and remanufacturing aircraft announced expansion plans. An insurance processing operation will employ 400 in Sioux Falls, S.D., and a software firm will hire 50 in Duluth, Minn. One computer materials plant employing 100 people will close as the parent firm streamlines operations.

Construction and real estate
“Business building booming,” was the headline for a Sioux Falls news story, but could have applied as well in Minneapolis-St. Paul, Eau Claire, Wis., Fargo, N.D., or other urban areas where industrial, commercial and office construction is very robust. “New home sales soaring,” was the word in Minneapolis-St. Paul where January new permits ran 7.2 percent above 1997. Residential builders are busy and anticipate a good year in virtually every city over 10,000 population, with the exception of a few in Montana. Publicly let building and infrastructure projects are running about even with last year’s record pace.
Natural resource industries

Oil output in North Dakota has risen to its highest point this decade, and drillers for both oil and gas in that state and Montana continue to benefit from a mild winter. However, while rig counts remain high compared to earlier in the decade, industry sources warn that dropping energy prices soon will curtail drilling since most wells in the district are high-cost relative to yield.

Lake Superior iron mines anticipate overall production slightly above the 16-year record output set in 1997, but express concern about how lower Asian currency values may boost U.S. imports of steel and steel-containing products from that region. One mine cut its projected output slightly and laid off some 20 workers. A Montana gold mine closed with the loss of nearly 300 jobs due to low gold prices and to unrelated financial problems in the parent firm.

Forest product output is expected to be largely steady in western areas of the district due to cutting constraints, but strong in Minnesota and Wisconsin as oriented strand board plants run at capacity to meet builders’ demand. Paper production is described as steady to moderately stronger.

Agriculture

“The mood among wheat farmers is pretty grim,” says one Montana implement dealer. That observation has been true for several months, but recent declines in corn, soybean and hog prices have extended the region in which farmers are under financial stress. “The bloom sure came off the hog market in a hurry,” says a southern Minnesota banker. Slaughter hog prices have dropped to the low $30 per cwt range, down 40 percent from a year ago and 20 percent from early December. Corn and soybean prices have also weakened from early winter, though relative to costs are still more favorable than that of wheat. Farmers in the western Dakotas and Montana are concerned about unusually small snowpacks, low reservoir levels and inadequate soil moisture.

Banking

Pricing competition reportedly is intense. A senior correspondent banker remarks that “banks may have come to the point where they simply cannot lower prices.” The competition for loans raises some bankers’ concerns about future credit quality. Loan volume is good overall but there remains considerable variance by locality. Like loan demand, liquidity is good overall with substantial variation by locality.
Consumer spending and tourism

"Retailers report strong February," headed a news article on sales by Minnesota-based national firms. The report cited warm weather as a positive factor for electronics, appliance, apparel and other consumer product sales nationwide. A regional chain also reported good sales, which is supported by reports from mall managers in urban areas. Several sources report softening sales in nonurban areas of the Dakotas and Montana.

Vehicle sales remain mixed, with continued slowness in Montana and rural areas of the Dakotas. Minnesota and Wisconsin sales are reportedly “stable” and “a little above last year.” “We aren’t getting the benefits of mortgage refinancing that we did a few years ago,” says one auto dealer.

Unseasonable warmth and inconsistent snowfall across the district produced uneven results for tourism businesses. In the Upper Peninsula of Michigan, a tourism official reports that the snowmobile season and some ski hills ended early due to lack of snow during February. A chamber of commerce in northern Wisconsin expects winter tourism to be 15 percent to 20 percent lower than last year. While snowmobiling was stifled in northern Minnesota, a downhill ski resort expects a 10 percent increase for the season. Recent snowfall in South Dakota has boosted snowmobile traffic and inquiries to a local tourism office.

Employment, wages and prices

The recent headline “Newspapers reap bounty as classified ad volume soars,” highlights one sector benefiting from extreme tightness in labor markets. Minneapolis-St. Paul newspapers have seen double-digit increases in help-wanted ad revenues in each of the last three years. With unemployment rates at or near record lows, most urban businesses in the district feel labor market tightness in one way or another. While extensions of benefits, hiring bonuses and so forth are quite common, across-the-board wage and salary increases generally remain in the 2 percent to 4 percent range. Minneapolis-St. Paul hourly earnings in manufacturing are about 2 percent above year-earlier levels.

Energy prices remain well below year-earlier levels. With such prices and with warm weather, household heating costs in most areas are the lowest in many years. Gasoline prices are down as much as 20 cents per gallon from early 1997. Commodity and intermediate good prices are down or quiescent. Increased prices at the consumer level are relatively rare.
Overview. The district economy continues to grow at a moderate pace. During the past month retail sales edged up, construction activity picked up slightly, and manufacturing activity remained fairly strong. One weak note was a slight decline in energy activity. In the farm economy, the winter wheat crop is in good shape, and the quality of wheat pasture is good to excellent. Labor markets remain tight in much of the district, with continued evidence of moderate wage pressures. Prices generally held steady at the retail level and for construction materials. Price changes were mixed for manufacturing materials, with some slight increases for some materials and declines for others.

Retail Sales. Retailers report sales edged up last month, and were moderately above year ago levels. All respondents expect to continue growing sales over the next three months. While most retailers thought current stocks were too large, they do not anticipate major changes in inventories in the coming months. Automobile dealers report mixed results last month, with sales overall moderately lower than a year ago. Sales of sport utility vehicles and light trucks remained strong, while sales of passenger cars were weak. Dealers have trimmed inventories slightly and are generally satisfied with current stock levels. Respondents expect to increase inventories to match seasonal stronger sales in the coming months.

Manufacturing. Manufacturing plants operated at moderately high levels of capacity last month as activity continued to expand. Purchasing managers report that raw materials were generally available and there were no noticeable changes in lead times. Inventories edged down last month, and further reduction is expected in the near future as stocks exceed desired levels. A quarterly survey of district manufacturers indicate that production increased slightly, while
shipments and new orders both posted slight declines from December 1997 to January 1998. New orders from exports also declined slightly, reflecting lower export demand from Asia and the effects of a strong dollar.

**Housing.** Builders report housing starts rose slightly last month, moderately above year ago levels. Builders anticipate additional gains in construction activity in the coming months as mild weather provides a seasonal lift. Sales of new homes were slightly higher last month, above levels reached a year ago. Inventories of unsold new homes remain at moderate to slightly high levels. Most building materials were readily available and delivery times were normal. Mortgage lenders say demand was up slightly last month, boosted by a rush of refinancings. Mortgage demand for home purchases is expected to increase somewhat in coming months while demand for refinancing is likely to level out from the strong increases registered in previous months.

**Banking.** Bankers report that loans and deposits generally held steady last month, leaving loan-deposit ratios little changed. All loan categories were flat except home mortgages, which increased somewhat. Money market deposit accounts edged up, NOW accounts declined slightly, and other deposit categories remained unchanged. Almost all respondent banks left their prime lending rates unchanged last month and expect to hold rates steady in the near term. All banks held their consumer lending rates constant and most banks anticipate no future changes. Lending standards were unchanged.

**Energy.** District energy activity edged down in the last two months after short-lived improvement in activity in December. Mild winter weather contributed to further decline of both crude oil and natural gas prices last month. Both prices remained well below year-ago levels.
Reflecting lower prices, the district rig count was down 5.0 percent in January and fell another 1.4 percent in February to a level only 1.3 percent higher than a year ago.

**Agriculture.** The district's winter wheat crop is in good condition, and the quality of wheat pasture is good to excellent. Relatively high prices for feeder cattle should help ranchers earn modest profits in 1998. However, operators of cattle feedlots are losing money due to low prices for slaughter cattle and the losses may persist through the first half of the year. Low hog prices have not slowed expansion by large, integrated operations, but many smaller producers are liquidiating their herds. Farmland rents around the district have continued to edge up. Rural businesses are earning modest profits.

**Wages and Prices.** Labor markets remained tight last month in much of the district, with continued evidence of moderate wage pressures. Retailers report a shortage of entry-level workers due to the availability of other jobs at higher wages in other sectors. Manufacturers have began to report low-skill labor shortages in addition to ongoing problems hiring skilled and technical workers. Builders say workers are hard to find in general, but framers, brick layers, and dry wallers are especially difficult to hire. Some companies have raised wages more than in the recent past to attract or retain workers, while many say wage increases are about average. Retailers report that prices were generally unchanged last month. Prices increased slightly for some manufacturing materials, such as rubber and carbon, and edged down for chemicals. Prices of construction materials held steady. Retailers expect no major price changes in the coming months.
Over the past six weeks, Eleventh District economic activity grew at about the same pace as or a little slower than reported in the last Beige Book. Prices of most manufactured products were flat to down while service and construction-related industries continued to report upward price pressures. Manufacturers saw slightly slower sales growth, but retailers reported stronger than expected sales. Consumer borrowing increased with new home purchases, but wet weather slowed construction starts. Service industries reported growth was steady, but constrained by a shortage of labor. Energy activity remained strong but showed some hints of softening. Agricultural conditions remained favorable.

Prices. Goods-producing contacts reported more price declines than in the previous Beige Book, but some construction materials and service producers reported increases. A number of contacts reported commodity price decreases because of the Asian crisis, but some contacts indicated the decreases were not as large as previously anticipated. Excess capacity weakened prices for some manufactured goods.

Prices were lower for some petroleum products, memory chips, telecommunications products, and some metals. Crude oil and gasoline prices continued to decline and are lower than last year’s levels. Although natural gas prices are higher than a year ago, they have fallen recently, and some contacts expect further declines. Respondents reported that excess domestic capacity for ethylene and propylene, increased imports of polyethylene bottle plastic from Asia, and increased domestic supplies of plastic resins like acrylonitrile, polyvinyl chloride and butadiene resulting from reduced exports to Asia have combined to reduce prices for many petrochemicals. Prices for telecommunications equipment continued a steady downward trend, but most respondents reported an accelerated decline in the price of memory chips as a result of the combined effects of overcapacity and the Asian crisis. Contacts also reported that increased imports from Asia lowered scrap metal prices by 2%, and have put downward price pressure on raw materials such as nickel and ferro-moly alloys.
Prices for retail goods, forest products, and heating oil were flat. Retailers reported that prices of goods imported from Asia did not decline as much as they had expected a few weeks ago, but some retailers expect further price declines in the third and fourth quarters. Apparel industry contacts reported that Asian apparel manufacturers and textile producers have not been able to move swiftly into the United States because they lack the reputations and distribution networks necessary to do so. Paper manufacturers reported limited effects from the Asian markets because Asian-produced paper includes more recycled content than does U.S.-made paper. Heating oil prices were unchanged but well below year-earlier levels.

Strong construction activity translated into a 5% increase in high-grade steel prices, a 2.5% increase in brick prices, and a slight increase in cement prices. As the weather improves, contacts expect cement prices to rise another 5% and soft lumber prices to increase 10% to 15%.

Service fees increased, but at a slower rate than service wages and salaries. Salaries for engineering and software design were up. Construction wages were also up, but contacts reported that tight margins for builders limited wage increases. Lumber producers reported 10% wage increases. Conversely, the rise in the minimum wage was binding for retailers and apparel manufacturers.

Manufacturing. The growth of sales for manufactured products was slightly weaker in the past six weeks, particularly in the telecommunications and petrochemicals industries. While sales of cellular telephones and Internet products continued to grow, a decline in sales of switching equipment left overall sales of telecommunications equipment flat. Domestic sales of petrochemicals were reported to be very strong, but sales to Asian markets were weak. Petrochemical producers said problems with rail shipping may have worsened. Contacts had difficulty shipping petrochemicals westward from the Gulf Coast, and said that several customers have temporarily shut down plants because petrochemicals were undelivered. Refiners reported that the demand for oil products was weak and inventories of crude and heating oil are large and growing. Prices for refined products have fallen as fast as crude prices, and contacts reported that margins have stagnated at levels that are
considered mediocre to poor. Respondents indicated that they are responding to high inventories and low margins by extending and increasing the maintenance normally done in the turnaround season, when they switch the product mix. Sales of some construction-related products—such as cement and lumber—were slowed by the drop in construction that resulted from a wetter than usual February, and are expected to grow strongly with drier conditions. Most electronic equipment manufacturers said that sales continued to grow at the slower pace that was established over the past three or four months. One respondent reported that he had to seek out new suppliers because capital constraints had reduced the output of his Korean suppliers. Scrap metal and paper sales were steady at high levels, but scrap metal inventories were high due to rail shipping delays. Sales of brick and high grade metal increased over the last 30 days.

Services. Demand for business services, including temporary staffing, accounting, consulting and legal services, continued to increase, but all respondents reported difficulty meeting demand due to a dearth of workers from clerical to executive. Respondents also noted a decline in demand for accounting services in Houston as the result of oil price declines. Overall, respondents had a very positive outlook for business service conditions in 1998. Demand for transportation services continued at high levels, both for cargo shipments and passenger air traffic. Contacts reported that Union Pacific tie-ups have not improved.

Retail Sales. Retailers reported that sales growth was stronger than expected in February, with particularly strong growth at stores along the Texas-Mexico border. Contacts were optimistic about the outlook for sales in the coming year. Auto sales slowed in February after surging “phenomenally” in January.

Financial Services. Credit quality remained steady and competition for commercial loans remained strong with many customers receiving several loan offers. Contacts also reported increased consumer borrowing for home purchases, brisk refinancing activity and seasonally soft auto loan demand.
Construction and Real Estate. Real estate activity continued at a hectic pace, but construction was slowed by unusually wet weather. Respondents expect a surge in construction in the second quarter—possibly sufficient to create a shortage of skilled workers, project supervisors and estimators. Home sales were up strongly across the District, including areas which had been weak such as the Texas-Mexico border, and inventories were lean. New home prices rose at a faster rate, but builders’ margins continued to be squeezed. Office rents “inched up” at the same rate, and industrial rents rose at a faster pace as office market demand spilled over into flex space. Land prices continued to rise sharply.

Energy. Energy activity remained strong in February, with some hints of softening. The outlook has weakened substantially since the last Beige Book. Crude oil inventories are large and growing, thanks to a very mild winter in the United States and Europe, reduced demand from Asia, and increased production from OPEC. Still, oil service and machinery companies continued to report very strong demand and very long lead times, and contacts said that they expect orders to remain strong for several months. Natural gas production remained flat compared to last year, with contacts expressing concern that companies may be having trouble bringing new capacity on line because of a shortage of oil field services. Nonetheless, there were some reports that it was becoming easier to schedule services and that some oil service price increases had been rescinded. There were also reports that some oil companies are paring back on their projected office space needs for 1998.

Agriculture. Agricultural conditions are reported as generally good across the District, with mild temperatures and good rains. Wet conditions temporarily halted land preparations and early planting activity. Livestock conditions remained good, but wet pastures caused problems in grazing and feeding.
Summary

The Twelfth District continued its vigorous economic expansion, though with indications of moderation in some areas. The pace of retail sales was moderate. Both the manufacturing and service sectors experienced continued strong growth, although the restraining effect of the East Asian economic turmoil was evident in several sectors. The District banking and real estate sectors remained healthy overall, with the reports being more positive for California than for other parts of the District. Many respondents noted difficulties finding skilled and entry-level workers, and some reported larger wage increases than in the recent past.

Business Sentiment

Respondents remain optimistic regarding prospects for the national economy and their respective local economies. More than sixty percent of them expect national GDP to expand at its long-run trend and the current rates of unemployment and inflation to remain unchanged over the next year. Nearly three-quarters of the respondents expect more rapid growth in their regions than in the nation, although this percentage has declined during the last six months. Despite respondents’ generally optimistic views, the percentage expecting deterioration in their region’s foreign trade balance increased sharply, to nearly three-fourths, over the past six months.

Retail Trade and Services

The pace of retail sales was moderate in recent weeks. A respondent from a large supermarket chain reported flat sales in Idaho, Nevada, and Utah. Sales were somewhat slow at
department stores in Southern California and other areas, and several respondents noted weak demand and rising inventories for apparel. An automobile dealer in Utah reported that vehicle sales were weak during February.

Demand for most services, however, continued to expand very rapidly. Sales were particularly brisk for providers of telecommunications and cable television services. Respondents also noted rising demand for business and professional services up and down the West Coast. Deterioration in the trade balance with East Asia was reflected in reduced exports and increased imports through the ports of Los Angeles, Seattle, and Portland, with some decline in the total flow. Reports from Utah and Oregon indicated reduced tourist activity, and Hawaii's tourism sector has been hit hard by a drop in the number of visitors from East Asia. Southern California contacts reported that tourist business there has been affected somewhat by heavy rains but remains strong overall. Respondents in most areas noted ongoing shortages of information technology workers.

Manufacturing

Production and employment expanded further among manufacturing establishments, particularly those producing durable goods. The strongest demand conditions were reported for aluminum, for which market prices have risen about 20 percent recently. Orders for some types of machine tools rose, though the extent of backlogs varied substantially across companies in this sector. Boeing expanded its aircraft production further. The company still faces order backlogs, although order delays by East Asian airlines have grown. Respondents in many areas—particularly the Pacific Northwest—reported that the East Asian economic turmoil reduced
District sales of metals, lumber, pulp and paper, processed food, athletic shoes, and some high-tech products. Although production bottlenecks were limited overall, many respondents noted difficulties finding and retaining skilled computer and craft workers.

**Agriculture and Resource-related Industries**

The usual seasonal lull in the agricultural sector was exacerbated by adverse weather conditions and reduced demand from East Asia. Persistent severe rainstorms caused early crop problems in California, although their impact on the complete growing cycle remains uncertain. Declining demand from East Asian customers has reduced sales of District resource and agricultural products, particularly those from the Pacific Northwest. For example, both Alaskan salmon exports and Washington apple exports were down substantially compared to last year, and District wheat exports and prices were low. District beef and pork exports to East Asia also were down substantially, although this was partially offset by increased sales to Mexico.

**Real Estate and Construction**

Respondents reported enhanced real estate market and construction activity in California but reduced activity in some other areas. In California, construction activity and prices rose both in the residential and nonresidential sectors. In contrast, housing starts declined and expansion in nonresidential construction contracts reportedly slowed in Oregon. Housing starts also slowed in Utah, where most sales prices reportedly fell short of list prices. Nonetheless, the level of building activity in the District remained high, and respondents noted shortages of skilled construction workers in many areas, particularly Oregon, Nevada, and Utah.
Financial Institutions

Conditions at District banks were healthy overall, although industry trends appear to be more positive in California than elsewhere in the District. Loan activity remained high in most areas. Several respondents from the Pacific Northwest noted erosion of credit quality and use of less stringent underwriting standards. Loan demand and availability reportedly were high throughout California, with one respondent noting an easing of underwriting standards in the San Francisco Bay Area. Due to ongoing economic slack, two major Hawaiian banks announced large layoffs. Banks in most other areas reported hiring and retention problems, both for skilled categories such as loan officers and entry-level positions such as tellers.