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Summary of Commentary on \_\_\_\_\_

# **Current Economic Conditions**

by Federal Reserve District

June 1998

SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS  
BY FEDERAL RESERVE DISTRICT

JUNE 1998

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## Summary<sup>1</sup>

Overall, the U. S. economy continues its excellent performance. Output and employment are high while inflation is low. The economy continues to grow in all Federal Reserve districts and across most sectors. The pace of growth has varied across Federal Reserve districts, ranging from quite strong in the Northeast, much of the Midwest and the West Coast, to somewhat more modest growth in the Southeast and in the Dallas district. Growth is fueled by liberal consumer spending and by business investment in plants and equipment. The construction sector is very strong. Manufacturing is robust in several districts, notably Chicago, St. Louis and Kansas City, but somewhat weaker in an arc from Dallas through Atlanta and Richmond.

In agriculture, crop conditions are generally favorable, but crop and livestock prices are low. Oil and gas drilling continues slack, while output in other natural resource industries is generally stable. Seven districts report some adverse effects from economic problems in Asia.

### Household spending

The strength of the nation's economy is reflected in household spending. Boston reports 5 percent to 8 percent growth over year-earlier retail sales, while New York and Chicago describe them as above-plan or above expectations. Philadelphia and Richmond describe sales as healthy, Minneapolis as brisk, Kansas City and San Francisco as robust and Dallas as strong. Atlanta sees somewhat softer consumer spending, with most retailers saying "recent sales had gone as planned, but a significant minority noted their disappointment." In the Chicago district spending increased modestly, with sales exceeding retailers' expectations, while for St. Louis average sales are up 2 percent to 2.5 percent.

The composition of consumer spending varies somewhat by region. Home furnishings and related goods are strong in several districts. Summer clothing and other

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<sup>1</sup> Prepared at the Federal Reserve Bank of Minneapolis based on information collected before June 8, 1998. This document summarizes comments received from businesses and other contacts outside the Federal Reserve and is not a comment on the views of Federal Reserve officials.

apparel are strong in the Midwest, but mixed in New York. Motor vehicles are selling well in San Francisco, Philadelphia, Richmond, Kansas City and Chicago, but more slowly for Dallas and in rural parts of the Minneapolis district. St. Louis was one of several districts to note the effects of strong incentive programs on auto sales. Sport utility and luxury vehicles continue to sell more strongly than other models in many areas.

Tourism is strong in Boston, New York City and the Carolinas. Atlanta expects a very good season in Florida and notes record business at Mississippi casinos. Minneapolis district tourist businesses also anticipate a good summer season. San Francisco reports good tourist trade at present but anticipates some falling off in October.

### **Construction and real estate**

Construction is an engine of growth in many districts. Boston, New York, Minneapolis, St. Louis, Kansas City and Dallas all report vigorous home building. Cleveland notes a continued overall strong sector, with residential building up across its district but mixed activity in nonresidential categories. Home building is very strong in California, but softer in Oregon and Utah. Chicago's construction sector is bolstered by strong commercial building activity.

Several districts report strong market activity for existing real estate, both residential and commercial. Richmond relates that residential and commercial business was strong, but the pace of growth was moderating. Minneapolis notes that long waits for newly constructed homes are fueling interest in existing housing. Chicago and New York report tighter markets for office space in contrast to some softening in Philadelphia.

### **Manufacturing**

Manufacturing generally is growing strongly, particularly in the Northeast and Midwest but at a somewhat slower pace elsewhere. Chicago describes particularly robust manufacturing, especially in heavy equipment, appliances and steel. St. Louis reports vigorous activity, while Boston lists double-digit sales gains for aircraft components, power equipment, and medical and pharmaceutical equipment. Philadelphia notes

continued gains, and Kansas City says plants are operating at a high level of capacity. Minneapolis describes manufacturing growth as strong but not spectacular. Cleveland says that production is expanding at a slower pace than earlier in the year.

In contrast, manufacturing growth appears somewhat slower across the Southeast and South. Richmond says that shipments have declined recently and new orders are more modest. For Atlanta, production has increased but expectations reportedly are for some softening. Dallas similarly reports a slightly slower manufacturing sector, driven in part by sluggishness in the energy industry. But demand for construction-related goods in the Dallas district is so strong that items such as drywall and concrete are being rationed by suppliers. San Francisco notes expanded output overall, but deceleration for some products, particularly those affected by slack demand in Asia.

### **Agriculture**

Conditions for farmers vary widely depending on region and crop or livestock enterprise. Crop conditions are good in most areas, especially the corn and soybean areas of the Chicago, St. Louis and Minneapolis districts. Kansas City anticipates excellent winter wheat yields on a somewhat reduced acreage from a year earlier. Richmond also anticipates good yields for its grain producers. Exceptions to this general pattern are wheat growing areas of Montana and the Dakotas, where drought is a concern as it is for some Dallas district farmers. Cleveland notes mold problems for Kentucky tobacco growers as well as a short wheat crop there. Moreover cold, wet weather has hampered some fruit production in California and the Carolinas. Crop prices remain depressed in response to anticipated strong yields and weak export demand.

Low cattle and hog prices are putting pressure on producers' bottom lines, although Chicago notes some recent improvement in hog prices from lows experienced earlier in the year. San Francisco and Kansas City report that cattle feeders are losing money.

**Other natural resource industries**

All districts reporting on oil and gas drilling describe it as slack. Dallas notes further slowing of drilling due to large stocks of gas and oil. The energy sector is also weak in the Minneapolis district, with gas somewhat better than oil. Kansas City reports a slight uptick, though activity remains well below year-earlier levels.

Iron mining sources in the Minneapolis district indicate that 1998 output should match the strong pace set in 1997. Forest product output apparently is stable. Paper manufacturing reports are mixed, with Minneapolis describing profitability varying among grades of paper and Dallas noting increased pulp imports. For Atlanta, mills are still operating below capacity, but with some improvement.

**Banking and insurance**

Banks and other financial firms are generally in good shape. San Francisco reports stronger demand for loans by businesses than by consumers. Dallas sees increased consumer borrowing, except for auto loans. Kansas City describes higher lending to consumers and agriculture. Minneapolis says that while loan volumes continue to grow, the growth rate has slowed somewhat, and lenders are becoming somewhat more cautious. Bankers in the St. Louis district reportedly describe loan demand and competition as strong. Lending to consumers and businesses in the Chicago district is apparently very brisk, and loan quality may be improving. Banks' loan business is also strong in Richmond, Philadelphia and New York. Boston describes slack demand for traditional life insurance, but increasing interest in lines such as group disability policies as employers increase employee benefits.

**Employment, wages and prices**

Employment levels are high and labor markets tight in most areas. While no district reports widespread increases in general wage levels, reports of increases in occupation-specific, targeted or nonwage compensation are frequent. Boston, Atlanta, Cleveland and Chicago cite acute shortages of information technology workers and say that some jobs

are going unfilled. Boston notes that tight labor markets are not yet leading to sizable wage hikes but says that temporary employment firms are expanding sharply. Cleveland reports some acceleration in compensation costs amid indications of tight labor markets. Richmond says that demand for workers remains intense but overall wage pressures are still mild. Similarly, Atlanta describes labor shortages as plaguing parts of its district, but with little upward wage pressures. Chicago sees signs of broad-based labor shortages, with wages rising in specific occupations and at the lower end of the pay scale, but reports that general wage pressures are still subdued. Demand for labor remains strong in the St. Louis district, with some upward pressure on wages noted. Minneapolis continues to have very tight labor markets with widespread nonwage compensation increases despite overall restraint of base wage increases. Kansas City reports continued, but not increasing, moderate wage pressures in very tight labor markets. Dallas made note of firms' widespread difficulty in hiring skilled workers and their use of targeted wage increases. Construction workers are in short supply in the San Francisco Bay area, though there is some easing of employment among high-tech manufacturers.

Despite indications of tight labor markets in all districts and higher compensation costs in several, prices of goods are largely stable. Boston and New York report manufacturing input costs as flat or down. New York purchasing managers see upward pressure on contracted services, with most firms reporting unchanged input and output prices. Cleveland and Atlanta note largely stable commodity, input and finished goods prices. Minneapolis says that commodity and energy prices are holding down increases in the general price level. Price changes are mixed in the Dallas district, with the preponderance lower. San Francisco cites some cost increases for services.

### **Inventories**

Reports that mention inventories generally describe them as at normal levels relative to sales. Philadelphia reports stable manufacturing order backlogs and inventories and retailers' inventories at appropriate levels. Cleveland describes some upward movement in

inventory levels but categorizes them as in line with production levels. Atlanta views inventories as generally on target, while Chicago says retail inventories are “in good shape.” St. Louis and Kansas City say that most retailers are managing inventories at lower levels, although some auto dealers have too many cars on hand. Minneapolis notes some evidence of shorter delivery times and higher supplier inventories.

### **Asia**

Seven districts made specific note of effects from economic problems in Asia. Boston says such troubles have held down some input prices and reduced demand for some manufactures. New York describes incipient price reductions for imported electronics and apparel. Philadelphia lists declining orders from Asia for primary metals and construction materials. Richmond sees more effects from import competition in apparel and textiles than on exports. Chicago steel producers are facing increased competition from Asia and high-tech and electronics is also suffering. Dallas lists weak Asian demand for petrochemicals and telecommunications gear. San Francisco district producers of computer components and lumber also have seen a drop in sales to Asia.

FIRST DISTRICT - BOSTON

The First District economy continues to expand. Most contacts in manufacturing, retailing, personnel supply, and even insurance report ongoing growth in revenues. Selling prices are mostly level, with some input price declines attributed to Asian markets. Respondents say tight labor markets are still not leading to sizable wage hikes. Residential real estate markets are doing well throughout New England.

Retailing and Tourism

Most retail contacts report that sales grew at a healthy pace in the March to May period, up 5 to 8 percent from a year earlier and at or above expectations; tourist-related business is growing even faster. Sectors of strength are consumer electronics, home furnishings, building materials, and general retail; footwear is weak.

Employment is generally reported to be holding steady on a same-store basis. Hiring is up, however, because tight labor markets have led to increased turnover and retailers that are expanding operations are raising head counts. Nonetheless, shortages are reported only for information technology professionals. Base wage growth is said to be in the 3 to 5 percent range; contacts indicate they are switching to incentive pay systems to keep labor costs down.

Most respondents report that their selling prices are steady. The exception is tourism in the Boston area, where excess demand for hotel rooms is bidding up room rates; hotel rates in the rest of the region are rising more modestly. Troubles in Asia are said to have led to declines in some vendor prices, notably for lumber and fuel. Most contacts say that profit margins are holding steady, with input price declines being offset by wage growth in excess of productivity improvements. With the exception of tourism, respondents are planning modest capital expansions this year. Many contacts are investing heavily in computerization, including inventory control systems to improve efficiency.

Looking forward, contacts expect strong sales growth to continue. Nonetheless, all express some uneasiness about how long the economic expansion can continue.

Manufacturing

About three-quarters of the First District manufacturers contacted indicate that recent business is

up from a year ago, with considerable variation across products. Respondents report double-digit sales gains for aircraft components, power equipment, and medical and pharmaceutical equipment. Industrial machinery orders are said to be growing nicely or recovering. Sellers of automotive components indicate mixed results. The demand for microelectronics products, electrical equipment, and apparel textiles is reported to have softened. Several companies cite double-digit reductions in sales to Asian markets. Looking forward, manufacturers are fairly upbeat, although the downturns in the microelectronics industry and in the Asian economies are expected to limit revenue growth for some firms.

Almost all manufacturers indicate that materials costs are flat or down. They report that costs for oil-based products, metals, and wool are lower than a year ago, although two now expect metals prices to recover somewhat. Manufacturers are paying sharply higher prices for travel and outside programmers, but they say that competition and their own efforts to seek alternative suppliers are keeping a lid on the costs of other services.

With few exceptions, manufacturing output prices are said to be stable. About one-half of the companies mention downward pressure on prices coming from cost-reduction efforts of customers in the automotive, health care, and office supply industries, declining currency values in Asia, and competition.

Overall employment levels have been fairly stable over the past year for about two-thirds of the manufacturers contacted. The remaining one-third is split equally between large increases and large decreases. Some contacts report limited availability and escalating pay scales for selected categories of professional and technical workers. However, manufacturers do not report widespread difficulties in hiring and they mostly cite overall wage and salary increases in the range of 2 to 4 percent. A few mention expanded use of incentive-based pay for blue-collar workers.

#### Temporary Employment Firms

Expansion at First District temporary employment firms continues. Most contacts report double-digit revenue growth. Labor markets are described as extremely tight; respondents say the gap between supply and demand has remained unchanged over the past six to nine months. Wage growth is said to be averaging 10 percent annually, ranging from 5 percent for less-skilled occupations to as much as 20 percent for highly skilled technical workers. Contacts are feeling squeezed as their clients resist price

increases. Any growth in profits is attributed to efficiency gains or increased sales volume. Outlooks for the next twelve months are positive, but most respondents expect some softening in the economy.

#### Residential Real Estate

Residential real estate in New England continues doing well. Markets have been very active throughout the region, and the number of sales has increased in most areas. Massachusetts and New Hampshire contacts report the largest rise in sales, but Connecticut, Vermont, and Maine have also experienced some increase. Almost every area is experiencing inventory shortages. However, the increased activity and low inventory levels have not yet led to substantial price hikes; average prices have remained stable or increased modestly. The market for new construction is very active and spec construction is noted in some areas. All contacts indicate that potential buyers are confident and optimistic about the economy; they expect markets to remain active at least through the third quarter.

#### Nonbank Financial Services

Respondents at insurance companies report first-quarter 1998 revenues ranging from flat to up 17 percent. Purchases of traditional life insurance are said to be flat or down; any increases are due to continued growth of mutual funds and annuities. Contacts report significant increases in sales of group disability insurance, largely due to demand from smaller employers who appear to be responding to the tight labor market with improved benefits. Respondents among property casualty insurers report continued downward pricing pressure in commercial lines. Employment is generally level. Most respondents note continued shortages of computer programmers, especially those to work on the Y2K problem. Some also report difficulty filling high-level professional positions in underwriting, accounting, legal, and finance.

#### The Outlook

The New England Economic Project (NEEP), a nonprofit forecasting group, released its semiannual five-year regional forecast in May. NEEP expects regional employment to expand 2.3 percent in 1998, followed by increases of 1.1 to 1.4 percent in subsequent years. Among industries, average annual job growth is projected to range from a low of 0.2 percent in manufacturing to a high of 2.5 percent in services.

## SECOND DISTRICT--NEW YORK

The pace of economic growth in the Second District has picked up since the last report. Most retailers report that sales continued to run ahead of plan in May, led by home-related goods. Retailers also report that both selling prices and merchandise costs were flat to down slightly, with one contact anticipating further downward price pressure in the months ahead; no increase was reported in retail wage pressures. Single-family housing markets in and around New York City tightened further, while New Jersey's remodeling boom has continued unabated. Office rents in Manhattan rose again at a brisk pace in April, while vacancy rates held steady at a low level.

Regional purchasing managers report that manufacturing growth rebounded in May, following a brief pause in April, while input prices were flat to slightly lower. Tourism remains brisk in New York City and appears to be picking up in western New York State. Finally, local banks report further declines in consumer delinquency rates and continued moderate growth in loan demand.

**Consumer Spending**

Most major retailers report that sales in the region were above plan in May, led by home-related goods. General merchandise retailers report that same-store sales were flat to up 6 percent, while discounters generally experienced stronger gains. Virtually all contacts noted particularly strong sales of goods for the home—bedding, furniture, appliances, and home-improvement merchandise. However, apparel sales were mixed, with a number of retailers reporting some weakness in children's and infants' clothing, as well as accessories and cosmetics. Retail inventories are generally reported to be at satisfactory levels, although one contact notes lean stocks of apparel and various seasonal merchandise.

Retail selling prices and merchandise costs were steady to down slightly. While most retailers report only modest cost savings on Asian imports, one contact notes that reduced-price electronics from Asia are now reaching the store shelves, and that apparel prices are expected to decline noticeably

beginning in August. While there were no reports of significant wage pressures or increased labor shortages, a number of contacts express concern about recruiting and retaining staff during the peak hiring season in late autumn.

### **Construction & Real Estate**

Housing markets in New York and New Jersey continued to strengthen in the early part of the second quarter, led by the single-family sector. Permits to build detached homes continued to trend up in April, with year-to-date sales running more than 15 percent ahead of 1997 levels. More recently, a number of homebuilders in northern New Jersey report that sales have picked up significantly in May and early June; selling prices have also risen in line with escalating land prices. In addition, New Jersey's market for existing single-family homes is said to be exceptionally tight, as reflected in the brief time that homes stay on the market and scattered reports of homes selling above the initial asking price. Remodeling activity also continues to boom; this is attributed to the state's old housing stock and a dearth of land available for new construction. Separately, New York State realtors report that unit sales of single-family existing homes continued to run 9 percent ahead of a year ago in April. Average selling prices were up 7 percent, reflecting price rises of more than 10 percent in the New York City area, combined with generally flat prices in the rest of the state.

The multi-family sector, which is also reported to be strong, may have reached a plateau. Permits to build apartments continued to retreat from exceptionally strong 1997 levels; year-to-date, they are down nearly 40 percent. Average prices of co-ops and condos in prime areas of New York City edged down in March and April but are still up roughly 3 percent over April 1997 levels.

New York City's office market remained tight in April, as commercial rents continued to surge, while vacancy rates steadied at a low level. Since the end of 1997, office rents have risen at an average annual rate of slightly over 25 percent in both Midtown and Lower Manhattan. However, vacancy rates

in both areas, which had been trending down since mid-1996, have leveled off in recent months.

### **Other Business Activity**

Local purchasing managers surveys indicate that the District's manufacturing sector rebounded moderately in May, following a growth pause in April. According to Buffalo purchasing managers, growth in new orders accelerated slightly in May after slowing in April, production activity continued to expand at a brisk pace, and hiring activity picked up moderately. New York purchasing managers report that business conditions in both the manufacturing and non-manufacturing sectors rebounded in May, after slowing in April. Both surveys indicate that prices of material inputs were flat to down slightly in May, though New York purchasers report persistent price pressures for contracted services.

Tourism remains brisk in New York City and may be picking up in western New York State. After trending up for four years, Manhattan's hotel occupancy rate has held steady at roughly 85 percent (seasonally adjusted) since the beginning of this year; however, room rates continued to rise at a rapid pace in April and were up roughly 10 percent from a year ago. Separately, bookings for future conferences in the Buffalo area are reported to have reached a record level in April.

### **Financial Developments**

According to a survey of senior loan officers at small and medium-sized banks in the District, overall demand for loans increased at about the same pace as in the last report. Consumer loan demand accelerated, while demand for mortgages and commercial and industrial loans leveled off. Refinancing activity was also stable. Bankers also appear increasingly willing to lend: 34 percent report increased willingness, while only 3 percent report less. Virtually all respondents indicate no change in credit standards over the last two months. Interest rates on loans declined over the last two months—particularly for commercial and industrial loans—while deposit rates remained steady. Delinquency rates fell slightly, led by the consumer segment, indicating continued improvement in credit quality.

THIRD DISTRICT - PHILADELPHIA

Most business sectors in the Third District were experiencing continued growth in late May and early June. Manufacturers' shipments and orders were increasing. Sales of general merchandise and motor vehicles were on the rise. Commercial and residential real estate markets were active, and home building continued to be strong. Despite the continued expansion in business activity, bankers in the region indicated that overall loan volume was just steady. There were gains in real estate lending but declines in consumer lending, and business lending has been flat.

MANUFACTURING

Third District manufacturers reported continued gains in May. About one-third of the industrial firms contacted said shipments and orders increased during the month; about half said they were steady. Improvement was noted in nearly all major manufacturing sectors in the region, but some producers of primary metals and construction materials noted that orders from Asia were still trending down. On average, order backlogs at Third District manufacturers have been steady, as have inventories. About three-fourths of the companies contacted for this report indicated that employment was steady in May, although firms in a variety of durable goods sectors added workers. Industrial prices have been steady; about eight out of ten manufacturers commenting on prices said both input costs and output prices were unchanged from April to May.

Looking ahead, area manufacturers expect continued moderate growth in the next six months. They forecast increases in orders and shipments, but they expect employment to remain

close to current levels. About one-fourth of the surveyed firms plan to increase capital spending, and a few firms noted plans for major expansions of capacity.

### RETAIL

Third District retailers generally described sales in May as healthy, continuing on the growth trend that began in April. Positive reports were received from all types of stores and for all lines of goods. Sales of home goods and apparel were said to be above expectations. Based on comments from the retailers contacted, sales appeared to be increasing at an annual rate of about 5 percent or slightly higher, in current dollars. In general, store executives said their inventories were at appropriate levels and selling prices were steady.

Auto dealers in the region generally reported growing sales during May and the first week of June. Generous manufacturers' incentives were credited for the increase. Dealers expressed satisfaction with inventory levels. Although some dealers voiced concern that the current upward trend in sales could soon falter, most were optimistic that sales will remain good as long as overall economic conditions remain positive.

### FINANCE

Total loan volume outstanding at major Third District banks has been level in recent weeks, according to bankers contacted in early June. There have been increases in home lending, but consumer loan volume has eased down. Bankers continued to describe commercial and industrial lending as extremely competitive for both large credits and loans to middle market and small businesses. Some banks said they have been increasing real estate-related business lending for residential development and some commercial construction projects, but overall business lending has not increased lately.

REAL ESTATE AND CONSTRUCTION

Contacts in the commercial real estate industry reported that Third District markets have been very active, with a strong pace of sales and leasing. Rents have increased in response to continued strong demand for modern office and warehouse facilities, although vacancy rates in the region have risen since the year began. The recent completion of several office and industrial buildings is cited as the main cause of the increase in vacancies; however, reductions in staffing at some downtown Philadelphia companies were also noted. The office vacancy rate for central Philadelphia is estimated at 16 percent, up from 13 percent at the end of 1997, and the rate for Wilmington is estimated at 7 percent, unchanged from year-end 1997. In suburban markets, vacancy rates range from 7 to 17 percent, about 2 percentage points above the range at the end of 1997. Commercial real estate agents expect suburban markets to remain active through the rest of the year, but they express some concern that corporate downsizings in Philadelphia and relocations out of the city could weaken the central business district market.

Home builders in the region generally reported a continuing high rate of sales in May. They indicated that buyers are favoring single homes and townhouses over condominiums and are increasingly contracting for higher-priced options in houses to be constructed. Average selling prices have increased a few percent from last year, according to builders, who also note that recent increases in the costs of materials and labor have moderated from last year. Real estate agents said the sales pace for existing homes has been increasing recently. Many noted that multiple offers for homes have become more common this spring than in the past few years; nonetheless, most said that price appreciation has been slim.

**FOURTH DISTRICT - CLEVELAND**

**General Business Conditions**

The District economy continues to expand amid relatively modest inflation. Some acceleration in wage growth has been seen, however.

Temporary employment agencies report that clerical help, general laborers, and warehouse workers are in extremely high demand and an increasing number of jobs are going unfilled. Some agencies have increased their wage rates several times this year. Furthermore, a much higher share of job placements is for permanent positions.

Sources in organized labor report seeing a modest acceleration in wage growth recently, from about 3% annually to a little above 3%. Contract lengths appear to be increasing, and the prevalence of cost-of-living clauses has diminished.

After dampening compensation growth for the past several years, the rise in medical benefit costs is outpacing wage growth. Still, fierce competition among health care providers is said to be having a moderating affect on the rate of the acceleration.

**Agriculture**

Excessively wet weather earlier in the year has yielded to drier conditions in the past month. Crop planting appears to be back on track or ahead of schedule in most parts of the District. A mild winter has benefited the winter wheat crop, which is expected to eclipse last year's levels by 5% in Ohio and 10% in Pennsylvania. However, Kentucky's winter wheat harvest is forecast to drop 7% from last year. The continued wet weather in that state is thought to be a contributing factor to the spread of blue mold, which has threatened some of the Fourth District's tobacco crop.

Compared to this time last year, the District has seen a 7% increase in the wages of field workers and a 3½% increase in the wages of livestock workers.

### **Construction**

Construction activity in the District appears to be continuing the strong growth trend begun several years ago. Residential building is up throughout the District, but commercial construction seems to be mixed by region. Commercial builders in northern Ohio report a marginal decrease in activity, but from very high levels. Reports of greater speculative development are heard in the Columbus and Pittsburgh regions for commercial construction, but not residential.

The costs associated with construction projects are holding steady overall. Land prices are rising at a slightly greater pace in the Cleveland and Columbus areas than they were earlier this year, but materials costs are generally flat. Although labor shortages are reported in most regions, wage growth for construction workers has been modest.

### **Manufacturing**

Industrial production is expanding, but at a more moderate rate than earlier in the year. Some slackening in orders has also been reported, with a notable exception being the Class A truck market, where orders growth accelerated sharply in May. Still, activity remains strong in many areas, and order books are reasonably full, despite the influence of a soft export sector.

Commodity and finished goods prices are holding steady, with the exception of some paper prices, which have been rising recently. Inventory levels are also reported to have moved up of late, but stocks generally appear to be in line with production levels.

**Consumer Spending**

May retail sales were mixed by retailer, region, and category. Discount stores tend to be at the high end of their sales plan, while department stores tend to be on or below plan. Retailers report notable strength in northern Kentucky, but other areas of the District have seen only modest gains. Furniture, housewares, and women's apparel are selling particularly well, but children's apparel sales are sluggish. Wholesale and retail prices are steady, and inventories appear to be in line with sales expectations.

Sales of new vehicles have picked up in the last two months and were especially strong in May. New vehicle leases are tapering off, commensurate with higher lease rates. A rise in used car sales has also been noted. Dealers are anticipating continued strong sales through the end of the model year, and inventory stockpiling is reported.

**Banking and Finance**

Lending activity in the District is strong in both the commercial and consumer areas. Demand for commercial loans is still growing amid broad-based gains. Consumer loan demand is moderately improved at most institutions, and a few banks report a very strong consumer loan market. Mortgage refinancing remains high, but growth in this area seems to be falling off a bit. Loan delinquencies are at low levels.

Competition for borrowers remains intense, and these pressures continue to squeeze the spread between borrowing and lending rates. Overall, credit standards and banks' willingness to lend remain constant, but a few institutions have repeatedly voiced concern about a persistent loosening in credit standards.

**FIFTH DISTRICT-RICHMOND**

**Overview:** In the weeks since our last report, the Fifth District economy continued to grow moderately, despite a pullback in manufacturing. Solid growth in personal income underpinned retail growth, and activity remained healthy in the services sector. Manufacturing stagnated, however, as shipments fell and growth of new orders moderated. Residential and commercial real estate activity continued to advance, although at a slower pace. Bank lending edged higher, driven by a pickup in commercial lending activity. Employers continued to face widespread labor shortages, but wage growth showed few signs of acceleration. Overall, price growth slowed somewhat in recent weeks, although manufacturers reported a slight uptick in materials prices.

**Retail:** Retail sales continued to post healthy gains in recent weeks. Purchases of durable goods were particularly robust, fueled mainly by a revival in auto sales. Merchants reported that shopper traffic kept pace with that of the previous Beige Book period. Retail inventories increased, partly in expectation of continued sales growth. Most contacts were a bit more optimistic in their outlook for retail activity in coming months, and some furniture and apparel retailers had recently added staff in anticipation of stronger sales. Prices in the retail sector rose at a slightly slower rate.

**Services:** Service providers experienced solid growth in the weeks since our last report; one South Carolina trade show promoter described the current business environment as “so good it’s scary.” While revenue growth was balanced across most service industries, those specializing in repair services noted the sharpest increase. In addition, businesses related to real estate and air transportation sustained their exceptional growth rates of recent months. The pace of price growth in the service sector slowed.

**Manufacturing:** Fifth District manufacturers reported that shipments declined and that new order growth was more modest since our last report. In addition, more producers indicated that their capacity utilization rates had eased. Production declines were most pronounced in the chemical, electronics, paper, and plastics industries. Despite the slower pace overall, a source with North Carolina’s Research Triangle Park said that biotechnology firms there were doing

“extraordinarily well.” Food producers also experienced more vigorous growth and tobacco producers saw activity bounce back from its slowdown in April.

Manufacturers remained concerned about the “Asian flu” impact, especially on the textile and apparel industries. While the crisis continued to hurt exports, the greatest effect remained increased competition from higher import levels. Most contacts expected these competitive pressures to rise further in coming months; however, one producer believed that textile quotas would soon be reached, restricting imports during the second half of 1998.

**Finance:** District banks reported somewhat higher lending activity in late April and May. Commercial lending was particularly strong. A banker in Greenville, S.C., told us that a number of companies there were pushing the limit on current plant capacity and were seeking financing to expand their production facilities. Mortgage lending remained brisk, bolstered by low and stable interest rates. According to one contact, demand for home mortgages was high because people who previously had been “sitting on the fence” were now convinced that mortgage rates were unlikely to drop further. Lending also was boosted by more intense marketing of equity-based lines of credit.

**Real Estate:** Residential real estate activity remained strong across the District in recent weeks, although the pace of growth leveled off. Realtors described home sales as strong in late April and May but indicated that sales and customer traffic were not quite at the levels seen earlier in the year. A Washington, D.C., realtor noted a slight slowing of business in May, but said there was “no end in sight for the good market.” Some contractors reported that residential building activity edged higher while others said there was little change. Housing starts fell in the Greenville-Spartanburg, S.C., area; this decline, however, was attributed to a shortage of experienced plumbers, brick masons, and electricians rather than to softer demand. Although there were scattered reports of higher costs for both labor and materials, the increases were generally modest.

In commercial real estate, growth also showed signs of moderating. While overall activity remained at high levels, office leasing activity in some areas appeared to be backing off from the hectic pace seen earlier this year; one contact said that in Virginia and West Virginia, activity had “slowed around mid-April and continued to be slower.” However, retail and

restaurant space was in greater demand, particularly in Virginia. In the Carolinas, business relocations were helping to sustain commercial real estate activity. “Booming” growth was reported for outlying areas of metropolitan Charlotte, N.C., and a contact there noted that the area was receiving “ten times the number of business relocation inquiries” than they had received a few years ago.

**Tourism:** Tourist activity strengthened further in recent weeks. Bookings for the Memorial Day holiday were much stronger than those of a year ago; one contact in the Outer Banks of North Carolina reported that hotels there were “almost booked to capacity.” Some hoteliers attributed the increase in bookings to an unusually early end of the school year coupled with higher consumer confidence and favorable weather conditions. In Charleston, S.C., the annual Spoleto Arts Festival of late May and early June had record-breaking attendance. Tourism officials in coastal areas expected that low gasoline prices and general economic strength would lead to an “incredible” summer season.

**Labor Markets:** Outside of manufacturing, the demand for workers remained intense since the last Beige Book. Retailers added workers to keep up with robust sales growth, and service firms continued to add employees at a high rate. Labor shortages persisted, and temporary employment agencies faced growing demand for workers, especially those with computer proficiency. In Charlotte, N.C., where the unemployment rate is 2.3 percent, one employment agent said that some firms were “talking about possibly relocating [outside the Charlotte area] to find the workers they need.”

Despite these reports, overall wage pressures remained mild. In the retail and services sectors, only scattered reports of substantial wage hikes were received. However, in one case, an employer said that her workers were disappointed when they received a 6 percent pay raise, “thinking it would have been more.” Contacts noted that signing bonuses were being offered more frequently, even for entry-level positions. In addition, employers in areas of low unemployment showed a greater willingness to pay the moving expenses of new hires.

**Agriculture:** Favorable weather conditions in recent weeks benefited District crops according to agricultural contacts. Small grains were generally in good condition and, with harvest approaching, producers anticipated excellent yields. Drier weather allowed farmers to

catch up on fieldwork; one noted that the respite from the rains allowed him to “put up one of the best hay crops ever.” In the Carolinas, the production of early peaches fell short of the normal level, and one producer said that prices were “as high as he’s ever gotten.” Livestock prices improved; one producer said that while cattle prices were “not setting the woods on fire,” they had moved above producers’ break-even levels.

## SIXTH DISTRICT –ATLANTA

**Summary:** Economic activity continued to push ahead at a stable pace in the Southeast, and the outlook is upbeat, according to most contacts. Merchants' sales in May were stronger than a year ago, and inventory accumulations are on plan. Single-family residential sales and construction are also above last year's figures. Commercial real estate markets remain healthy. Contacts in the manufacturing sector report mixed activity, with some industries registering renewed strength while others continue to decline. Tourism officials are optimistic about summer prospects. Bankers report moderate loan demand growth. Tight labor markets are causing problems for some District employers; however, increased wage pressures have been reported in only a few sectors. Most contacts report stable prices.

**Consumer Spending:** According to retail contacts, sales during May were weaker than April on a year-over-year basis. However, April sales were boosted by a late Easter holiday this year. Despite the weakening, most retailers reported that May sales exceeded last year's levels. Most contacts reported that recent sales had gone as planned, but a significant minority noted their disappointment. Inventories are generally on target. The majority of retailers expect that second quarter sales will slightly exceed last year's level.

**Construction:** Reports from real estate contacts indicate that home sales in May were above last year's levels in most areas of the District. Most District builders continue to report that new home sales and construction are ahead of last year, if only slightly. Contacts report that overall inventories are balanced; many noted that lower-priced homes are in high demand. Looking forward, builders expect that new home construction will be flat or slightly up on a year-over-year basis; Realtors are a bit more optimistic.

Commercial real estate markets remain healthy throughout much of the region. Office development generally continues at a strong pace; however, several markets are exhibiting some signs of slowing. The industrial market remains stable in most areas. Retail markets remain healthy across much of the region. Overall, both developers' and real estate agents' outlooks remain optimistic for the remainder of the year.

**Manufacturing:** Although more reports indicated that factory production has increased recently, more contacts than a month ago expect output and employment to weaken in coming months. Flagging new orders and plant shutdowns continue in the region's apparel sector. In Louisiana, bookings for onshore drilling and production equipment have decreased because the falloff in energy prices has forced independent energy extraction companies to cut back operations. Weak sales for its small cars has caused one large regional manufacturer to shorten its factory workweek, but continued strong demand for SUVs is boosting regional production of new utility vehicles and prompting some suppliers to expand. Although the pulp and paper industry is operating far below capacity, demand for paper products is reportedly slowly improving. New aerospace contracts are expected to boost factory payrolls in the Huntsville area and to benefit parts of Florida.

**Tourism and Business Travel:** The tourism and hospitality sector is expected to continue to post strong numbers into the summer, according to industry contacts. Recent reports indicate that attendance is good at major central Florida theme parks. Although tourist traffic into Miami leveled out in recent months, notable growth is predicted during the summer. Resort hotels in the Palm Beach area are reportedly fully booked, and the cruise industry in south Florida continues to boom. Two recently completed attractions in the Birmingham area are

expected to stimulate tourism there. Gross gaming revenues for Mississippi casinos have broken all-time records for the state recently and are expected to rise higher because some casinos will finish building new hotels over the next few months.

**Financial:** Bankers report that overall loan demand continues to expand at a moderate rate. Consumer and automobile loan demand have increased, according to most contacts, and commercial loan demand has maintained its strength. Home sales and refinancings continue to fuel the mortgage loan market. Overall, consumer loan quality is holding steady despite the ongoing high levels of bankruptcies relative to the past.

**Wages and Prices:** Labor shortages continue to plague parts of the District, but reports of upward wage pressures are not widespread. High-tech jobs are going unfilled in much of the District. The unfilled demand for welders in south Louisiana is estimated in the thousands, mostly because of the boom in shipbuilding. In Georgia, the retail sector has been the hardest hit by the labor shortage, according to state officials. One contact is concerned that the lack of workers will discourage corporate relocations to south Florida, and a major retailer has postponed expansion plans in the area because it cannot adequately staff existing stores. The tight labor market is reportedly forcing more companies to attempt to increase productivity by investing in more efficient equipment and ratcheting up training of current employees. Prices remain fairly stable for most inputs and finished goods, although one report indicates that low petroleum prices are taking a toll on independent producers in Louisiana. Other contacts note an end to the downward trend in health benefit costs.

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### SEVENTH DISTRICT--CHICAGO

**Summary.** The Seventh District's economic expansion picked up some momentum in April and May, despite significant shortages of labor. Virtually every economic sector continued to benefit from the extraordinary pace of construction activity. Consumers were buying appliances and other durables to stock their newly purchased homes; manufacturers were building earth-moving and other construction-related equipment; and bankers were busy meeting mortgage origination and commercial real estate loan needs. The District's labor markets tightened considerably since our last report and accounts of worker shortages became more frequent. Favorable weather in the Midwest allowed spring planting to make rapid progress in recent weeks while hog prices rose due to a seasonal decline in marketings.

**Consumer spending.** Overall consumer spending increased moderately in April and May, with sales results exceeding most retailers' expectations. A few national chains indicated that sales results in the Midwest were stronger than in other regions, with one asserting that it was the strongest in the country. Some items were selling better than others, but the strength was reported to be broad-based. Sales of furniture, electronics, appliances, and home improvement goods continued to benefit from robust housing activity in the region as well as warm weather. Apparel sales also benefitted from the warm weather, according to some contacts, with notable strength in men's and young men's sportswear. Strong light vehicle sales in May surprised some observers, and one contact noted considerable strength in the luxury segment. On the other hand, sales of auto parts (tires, batteries, etc.) and some auto services (such as body repair work) were softer than at this point last year. One contact blamed the mild weather in the Midwest, noting that there were fewer weather-related fender benders. Overall retail inventories were "in good shape" and there was no discernible change in promotional activity.

**Housing/construction.** Construction activity remained robust in April and May, boosted by a pickup in business construction. A supplier of construction materials indicated that shipments to commercial builders were up roughly 10 percent from last year while shipments to homebuilders were flat, but still very strong. Most contacts suggested that development of light industrial space (warehouses, etc.) was the strongest segment on the commercial side. Retail and office development remained strong, particularly in suburbs of some of the District's larger metropolitan areas. There was office tower development in some center cities as well, with ground having been broken for a 65-story office tower in downtown Chicago. The housing market may have softened somewhat in May, after exceptional strength earlier in the year. However, it remained very strong according to most contacts,

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with year-to-date sales levels and construction activity well above last year. Homebuilders throughout much of the region remained very active with one reporting that a "Parade of Homes" drew record levels of traffic through models, resulting in record levels of sales contracts. There was particular strength in the "move-up" segment of the market, according to this contact. One of the largest realtors in the District reported that April sales of existing homes set yet another monthly record and May's results were expected to be comparable. The brisk housing activity led to a pickup in home price appreciation this spring. Multiple bids on existing properties became more frequent, providing sellers with more leverage. Most realtors indicated that average prices in May were up about 5 percent from last year.

**Manufacturing.** Manufacturing activity remained very high in April and May and might have gained some momentum from our last report. This strength was nearly universal across industry segments. Producers of heavy equipment and appliances were the beneficiaries of the strength in construction industries. One producer of heavy/agricultural equipment and consumer products noted that demand for heavy construction equipment, as well as lawn and garden products, was particularly high and inventories were lean. New orders for agricultural equipment softened somewhat as a result of declining commodity prices. Steel production remained very high, in part due to strong demand from the makers of construction equipment. Capacity from minimills continued to come on stream and imports from east Asia began to reach the coasts; however, one analyst suggested that this increased supply was satisfying unmet demand and had not put a dent in domestic production. Steel prices were generally flat and the pricing environment remained weak. However, steel producers were successful in pushing through very modest price increases on some construction-related products. Automobile makers reported that production remained high and sales were strong, leading some analysts to increase their sales forecasts for the year. However, demand for light vehicles was again boosted by heavy use of incentives, and the pricing environment was still weak for most models. (At the time of our report, it was unclear how much production might be curtailed by strike activity in the auto industry.) One notable exception to the generally strong manufacturing picture was the high-tech electronics and electronic components industry, which was still suffering the ill effects of the "Asian Contagion." Production in this industry was down as were new orders and prices. One contact was concerned that conditions were not likely to improve any time soon. There were no new reports of raw materials shortages, and prices for raw inputs remained flat.

**Banking/finance.** Lending activity in the District remained very strong in April and May, with little change in momentum or asset quality. On the consumer side, overall lending activity was very strong and asset quality was said to be improving slightly. Though the refinancing boom was past its

## VII-3

peak, new mortgage originations remained “surprisingly” strong. One contact indicated that delinquencies were down and consumer credit quality improved recently. On the business side, lending activity remained very high and competition was still intense. Several contacts mentioned a pickup in commercial real estate lending activity with one District lender suggesting that this strength was “reminiscent of the late 1980s.” According to most bankers contacted, intense competition for quality business loans continued to put pressure on pricing but, as in previous reports, had not led to a lowering of standards. As a result, overall asset quality on business loans remained very high.

**Labor markets.** The region’s labor markets tightened significantly in April and May amid signs of broad-based labor shortages and continued strong demand for workers. The average seasonally adjusted unemployment rate for Seventh District states dropped to a very low 3.3 percent in April, a full percentage point below the national average. Initial unemployment claims through May were well below the levels experienced in the region for the same period in each of the last 7 years. The volume of help-wanted advertising in local newspapers and hiring plans surveys suggested that demand for labor in the Midwest remains higher than for the nation as a whole and above last year. Worker shortages were broad-based, though information technology workers and skilled trades occupations were more frequently cited as having been in short supply. While general wage pressures were subdued, the tight labor markets have led to increased wages in some occupations. There were several reports of increasing wages at the lower end of the pay scale, including some clerical occupations. There were also more frequent reports of increased employee turnover, particularly in lower skilled jobs, while one analyst noted that employers continue to “reach into their bag of tricks” to keep higher skilled workers in place by using longer-term incentives, such as stock options and profit-sharing.

**Agriculture.** District agricultural bankers reported that cash rental rates paid by farmers registered a year-over-year increase of 5 percent this spring, about half the percentage gain that occurred in farmland values. Recent weather in the Midwest was ideal for planting corn and soybeans. As of the first week in June, corn planting in District states was nearly finished, while soybean planting ranged from two-thirds complete in Illinois to 90% in Iowa. The current prospects for a large fall harvest have put downward pressure on farm-level corn and soybean prices. Corn exports continue to lag year-earlier levels and Midwest soybean producers face renewed international competition from the large and just-completed South American harvest. In contrast, District hog producers benefitted from stronger hog prices in May due to a seasonal decline in marketings and some pickup in demand from the start of the spring barbeque season.

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### EIGHTH DISTRICT - ST. LOUIS

#### **Summary**

Economic conditions across the District remain exceedingly good. Retail sales were up modestly in April and May. Large rebates and other incentives have helped boost car sales from their sluggish start at the beginning of the year. Other District firms continue to report strong activity, although the construction industry is feeling the squeeze from worker shortages. Real estate sales and construction are still surging from strong economies and low mortgage rates. The latest Manpower survey indicates that measurably more firms plan to boost their hiring in the third quarter compared with the second quarter. Strong demand from business customers has boosted loan demand at large District banks. Crop conditions are generally viewed as good-to-excellent across most of the District.

#### **Consumer Spending**

District contacts report that, on average, sales were up 2 percent in April and 2.5 percent in May over a year earlier. With summer approaching, athletic apparel and summer clothing have been hot sellers, while home electronic equipment has remained on the shelves. Most contacts state that their inventories are smaller than usual because of better inventory management. Most retailers have extremely positive outlooks for the summer.

Most of the automobile dealers surveyed have strong incentive plans in effect, which are scheduled to last at least through June. Dealers believe that recent strong sales increases, on the average of 4 percent in April and 5 percent in May over a year earlier, are a result of these incentives. While most dealers report inventories at satisfactory levels, some are still struggling with inventories that are too large. Most dealers believe they will have steady sales this summer, with some anticipating strong sales.

### **Manufacturing and Other Business Activity**

Most contacts report continued vigorous economic activity. Because of a scarcity of skilled workers, some additional upward pressure on wages has been noted. Contacts reports that this pressure has not passed through to consumer prices, with many citing productivity gains as the primary reason. Construction projects continue to be delayed because of labor shortages. And construction industry executives note that they are having trouble getting the “best and brightest into [the] industry.”

Several recent mergers in the District are expected to have wide-ranging employment effects on local economies; however, precise estimates are unavailable. Jefferson Smurfit bought Stone Container Corp. and will move its headquarters to Chicago. Monsanto plans to merge with American Home Products and move its headquarters to New Jersey. The new company plans to keep its agriculture division in St. Louis, however, which could leave employment unchanged or even increase it. United HealthCare of Minneapolis bought Humana Inc. of Louisville. United HealthCare believes it may move a division to Louisville, which could increase employment in the region.

### **Real Estate and Construction**

Low mortgage rates and solid local economies continue to spur strong sales of new and existing homes all around the District. Median home sales prices continue to rise and, in some cases, are up more than 10 percent from a year earlier. Construction of new homes is also on the rise because of strong demand. Monthly residential permits in April were up in nine of the District’s 12 metropolitan areas. In many cases, permit levels were up 20 percent or more. Compared with a year earlier, residential permit levels were up in eight metro areas. Memphis is the District’s only major metro area that is somewhat behind its year-earlier level. Nonresidential markets also remain relatively strong, with demand for office space staying tight as vacancy rates nudge down.

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### **Labor Outlook**

The demand for labor remains strong across most areas of the District. Manpower's quarterly survey of businesses in the four major cities of the Eighth District shows that employment gains in the third quarter are expected to improve further from three months earlier. Labor market conditions are expected to strengthen the most in Memphis, with nearly 50 percent of surveyed firms expecting to add to their payrolls over the next three months. Somewhat less optimism was expressed in Little Rock and Louisville, where 30 percent of those firms surveyed expect to add to their workforces. In St. Louis, only 18 percent of firms expect to add staff. In all four cities, however, the percentage of firms anticipating payroll reductions was 5 percent or less, compared with almost 10 percent a year ago.

### **Banking and Finance**

Total loans outstanding at a sample of large District banks rose 1.5 percent between late March and late May, compared with a 2.1 percent increase in the prior two months. The increase was mostly attributable to strength in business lending. Commercial and industrial loans jumped 4.4 percent over the period, while real estate loans rose 0.8 percent and consumer loans declined 3.1 percent. Bankers across the District continue to describe loan demand and competition among lenders as strong.

### **Agriculture and Natural Resources**

Favorable growing conditions were the rule rather than the exception during the month of May. In early June, conditions were enhanced further by widespread rainfall, which was quite heavy in some areas. The colder-than-usual temperatures that accompanied the rain, though slowing crop progress appreciably, is not expected to be much of a problem, except in a few isolated areas where spring planting was already behind. Regardless, the corn, soybean and winter wheat crops are in good-to-excellent condition in most areas.

## NINTH DISTRICT--MINNEAPOLIS

Overall, moderate to strong economic growth continues to prevail in the Ninth District.

Construction, retailing and manufacturing are robust. Tourism shows increasing strength. As in the previous report, areas where agriculture, mining or forestry predominate have much slower economies than the rest of the region. Crop farmers in particular are under financial stress due to low prices, and there are fears about possible drought in wheat-growing regions. Reports of increases in wages and in nonwage compensation are becoming more prevalent. Labor markets remain extremely tight in most areas.

### Real estate and construction

“House sale boom continues into fifth month,” headlines a Minneapolis news article on sales of existing homes. In May, such sales were 23 percent above year-earlier levels. For the year to date the increase is 18 percent. One realty spokesperson comments that buyer interest in existing homes is stoked by low interest rates and the long waits facing purchasers of newly constructed homes. Home building also continues strong in many other urban areas including Sioux Falls, S.D., Eau Claire, Wis., and Fargo, N.D.

Heavy construction, including roads and bridges, continues modestly above 1997 levels. Extremely favorable weather conditions allowed excavators and road builders to begin somewhat earlier than usual and activity is brisk.

### Manufacturing

Manufacturing output shows little change from earlier reports – general strength but not spectacular growth. Publicly traded firms continue to report strong earnings. Medical devices and electronic instruments continue as an area of strength as do all products related to construction. Output of tractors and agricultural implements, important in North Dakota, is sluggish, but machines which also have construction applications such as skid-steer loaders are selling well.

A regional survey of purchasing managers indicates some slowing of exports, particularly in Minnesota and a large commodity trading firm reported reduced profits due to Asian woes.

### Natural resource industries

“We are not going to see much improvement until oil prices pick up,” comments a North Dakotan on oil drilling in that state, which has fallen to its lowest level in over two years. A

somewhat more favorable market for gas has helped bolster drilling in Montana, but rig counts there are also somewhat below year-earlier levels. Forest product output is moderate to strong, with considerable variation in reports among manufacturers of different grades of paper. An iron ore industry representative says that output for 1998 should be about even with 1997.

### Agriculture

Low crop prices and concerns about scarce rains are raising concerns in farming and ranching. Favorable weather did facilitate early completion of spring planting in most areas, and crop development is well ahead of normal. But lack of moisture is increasingly serious in the western Dakotas and in Montana. Moreover, prices for most district crop and livestock products remain low, putting stress on farm cash flows and eroding balance sheets. North Dakota farm liquidations were at their highest level in more than a decade in early spring, particularly in areas that have had repeated adverse weather and plant disease problems in the 1990s.

Farm bankers responding to a Minneapolis Fed survey report that farm incomes and capital spending are slumping, and that there is some erosion in repayment rates. However, indications such as the number of borrowers against their debt limits remain somewhat better than a year to two years ago when low cattle prices had heavy impacts on western areas of the district.

### Banking

Loan growth has reportedly slowed in many areas throughout the district. One reported reason is a tightening of credit standards and terms by district banks, reportedly in response to continued increases in nonperforming loans and economic uncertainty in agriculturally dependent areas. Another respondent described banks as being "a bit more fussy" about extending credit.

### Consumer spending and tourism

"Consumers continue spree," heads an early June report on retail sales. Minnesota-based national chains as well as regional and local retailers in cities across the district generally report very good sales for late spring and for the year to date. Mall managers in regional centers also describe brisk traffic. The exception to this positive pattern continues to be retailers in rural towns where agriculture is the primary activity.

Sales reportedly are good across most categories of merchandise. Recreational goods again are singled out as particularly strong. Auto dealers also describe sales as good, though some express concern about customers becoming “addicted” to rebates, coupons and other promotions that maintain sales but cut into profit levels. Two sources describe structural change in auto retailing and predict that the number of dealerships will drop precipitously in the next five years. Sales east of the Missouri River are markedly stronger than in Montana and the western Dakotas. As with general retailing, sales reportedly are particularly slow in rural areas.

Tourism officials report a strong spring season and good prospects for summer. Some areas in the Upper Peninsula of Michigan reported 20 percent increases for May compared to a year earlier, while inquiries at a tourism office were up 30 percent year to date. Visitations to Duluth, Minn., were up 10 percent, according to a tourism official. Tourism sites in South Dakota report steady increases for May; campgrounds were booked full for Memorial Day weekend.

#### Employment, wages and prices

“Pay rises as firms scramble,” headlines a newspaper article regarding western Wisconsin, where unemployment rates are in the mid 2 percent range. The article noted that firms were having to raise wages for new and existing employees to get enough staff. But other firms reportedly are employing more targeted approaches. Participants in a special Ninth District Advisory Council meeting focused on labor markets noted that large across-the-board pay increases are still rare, but that many specialties are getting substantial raises and that nonwage compensation, including signing and retention bonuses, and broader benefits are rising sharply for some firms and that many are offering more flexible working hours and conditions. “The employee is in the driver’s seat,” said the personnel director for a large South Dakota based financial services firm. There are more reports of strike threats or strikes than in several years, although no strikes against major employers have occurred so far this year.

Low commodity and energy prices are helping to hold down the general price level. Fuel prices that remain below levels that prevailed for most of the decade are helping all parts of the transportation sector. One source reported price increases for some grades of steel, but another manufacturer described decreases. A few manufacturers report that delivery times on purchased inputs are dropping and that suppliers apparently have somewhat higher inventories.

## TENTH DISTRICT - KANSAS CITY

**Overview.** The district economy last month maintained the strong momentum of the first months of the year, and there appear to be no major signs of substantial slowdown in the near future. Retail sales repeated a robust performance, construction activity gained further strength, and manufacturing activity remained fairly strong. Energy activity improved slightly last month from the weak performance poster earlier in the year. In the farm economy, average to above average yields are expected for the winter wheat crop, and growing conditions for corn and soybeans are excellent. In contrast, operators of cattle feedlots and hog producers continued to lose money. Labor markets in much of the district remained quite tight, with some continued evidence of moderate wage pressures. Prices generally held steady at the retail level and for most construction manufacturing materials. Prices edged down for most manufacturing materials, with slight increases for a few others.

**Retail Sales.** Retailers continued to report robust sales last month, well above year-ago levels. Almost all respondents expect sales over the next three months to maintain the strong pace registered so far this year. Inventories last month expanded slightly, but most retailers are satisfied with current stocks and plan no major changes in the next several months. Automobile dealers reported improved results last month, with overall sales moderately higher than a year ago. Sales of sport utility vehicles and light trucks remained strong, while sales of new passenger cars improved due to incentives such as rebates and low finance rates. Inventories edged up, leaving most dealers generally satisfied with current stock levels. Respondents expect to increase inventories slightly in the coming months, however, to match seasonally stronger sales.

**Manufacturing.** Manufacturing activity remained strong last month with plants operating at high levels of capacity. Materials were generally available, except for a few items such as synthetic rubber. Relatively fewer respondents reported increases in lead times compared with the last survey period. Many managers are unsatisfied with current stock levels after watching inventories expand

slightly last month. Almost all respondents plan to trim inventories in the near future. A quarterly survey of district manufacturers indicated that production, shipments, and new orders all gained strength in April in contrast to seasonally low growth rates in the first months of the year.

**Housing.** Builders reported housing starts were up again last month, solidly above levels of a year ago. Additionally, builders anticipate further gains in construction activity in the coming months due primarily to strong economic fundamentals. Sales of new homes rose modestly last month, remaining substantially above year-ago levels. Inventories of unsold new homes are at low to moderate levels. Mortgage lenders say demand edged down last month but remained well above year-ago levels. Refinancing continued to lead mortgage activities. Lenders expect mortgage demand to stay strong over the next three months.

**Banking.** Bankers report that loans and deposits both edged up last month, leaving loan-deposit ratios unchanged. Consumer loans, residential construction loans, and agricultural loans all rose, while commercial and industrial loans declined somewhat. Increases in demand deposits, NOW accounts, and money market deposit accounts were partly offset by a decline in large CDs.

All respondent banks left their prime lending rates unchanged last month and expect to hold rates steady in the near term. Most banks held their consumer lending rates constant and anticipate no future changes. Lending standards were generally unchanged.

**Energy.** District energy activity improved marginally last month, despite lower energy prices. Natural gas prices fell in May, offsetting most of the gains registered in the two previous months. Crude oil prices fell again last month after a brief improvement in April. The district rig count rose 2.1 percent in May but remained 15.9 percent below year-ago levels.

**Agriculture.** The district's winter wheat crop is in good condition with average to above average yields expected in most areas, with overall harvest below last year's level due to low plantings. Spring planting is complete for corn and nearly complete for soybeans. Favorable weather following

planting has led to excellent growing conditions for both crops. Operators of cattle feedlots in the district continued to lose money last month, although the outlook is expected to improve later this year. Hog producers are expected to experience continued losses for the remainder of the year.

**Wages and Prices.** Labor markets remained very tight last month in much of the district, with continued, but not increasing, evidence of moderate wage pressures. Despite persistent problems hiring entry-level workers, fewer manufacturers reported general labor shortages this time compared to recent past months. In contrast, an increasing number of retailers were unable to fill positions in almost all levels. Similarly, continued robust construction activity resulted in builders facing strong labor shortages across the board, and even more severe for select trades such as framers. About half of the builders contacted indicated they have turned down work due to labor shortages. Despite tight labor markets, firms reported that wage pressures are moderate and stable, except for specific scarce skilled workers, such as information technology employees. Prices held steady at the retail level. Prices declined slightly for most manufacturing materials but edged up for a few specific items such as synthetic rubber and wires. Prices of construction materials were generally unchanged, with cement prices edging up in some locations. Retailers expect no major price changes in the coming months.

## ELEVENTH DISTRICT--DALLAS

Over the past six weeks, Eleventh District economic activity continued to slow slightly to a modest rate of growth. Manufacturing activity grew at a slightly slower pace than reported in the last Beige Book, and oil service and machinery companies reported that their business has slowed. Agricultural producers reported that dry conditions were causing problems in parts of the District. Demand for business services continued to increase but at a slightly slower pace. Financial service contacts reported steady credit quality and increased consumer borrowing. Construction activity continued to increase. Retailers said that sales remained quite strong.

**Prices.** Price movements were mixed over the past six weeks, with increases for some construction-related materials, produce imported from Mexico, wholesale gasoline, some gasoline inputs, and transportation services. Contacts reported declines in the prices of jet fuel, natural gas, crude oil, oil rig rental, memory chips, telecommunications equipment, apparel, coffee, finished metal products, soft lumber, aluminum, steel, several petrochemical products and autos. Contacts reported that crude oil prices weakened in late May when only 58 percent of the production cuts agreed upon by OPEC and non-OPEC countries had actually occurred. Respondents reported that continued weak Asian demand for petrochemicals has put increased downward pressure on prices of olefin and polyolefin as well as downstream products like thermoplastics. Paper producers said that they expect new capacity to dampen future prices.

Contacts reported continued difficulty hiring skilled workers and “skyrocketing” recruiting costs. Some respondents reported targeting wage increases to skilled workers in short supply, such as programmers, R&D workers, engineers, accountants, managers and administrators.

**Manufacturing.** Manufacturing activity grew at a slightly slower pace than reported in the last Beige Book. Sales of boxes, telecommunications equipment, semiconductors, chemicals, and some metals declined. One contact reported that declining sales to oil-industry customers has hurt some metal producers. Respondents reported increased pulp imports were boosting inventories at mills and causing a decline in the demand for caustic soda, an input in pulp production. Domestic chemical sales remained extremely strong, but weak sales to Asia caused increased domestic supplies. Telecommunications equipment sales slowed with declines in sales to Asia and a pause in new equipment investment attributed to anticipated merger activity. Sales of food, apparel, industrial and printing grade paper, wireless phones, some electronic components and construction-related materials increased over the last six weeks. Contacts reported short supplies of brick, as well as rationing of concrete and gypsum wallboard to builders.

**Services.** While business service contacts continued to report turning away business due to lack of workers, a few contacts also reported that demand grew at a slightly slower pace in the past six weeks. These contacts attributed the softening of demand to slackening in oil and gas exploration and production. Sources of strength included demand for support at customer service call centers and consulting for year-2000 office systems upgrading. Transportation services contacts reported “booming” business in trucking, an “awesome” over-65 percent load volume in passenger air traffic, and a slight increase in railroad freight volumes.

**Retail Sales.** Retailers said that sales remained strong. Some contacts said that sales were stronger than expected, and one chain has increased their forecast for this year’s sales growth. Contacts reported little or no increase in selling prices. Most retailers were not seeing price reductions for goods coming from Asia, but expect to in the second half of the year. Auto dealers saw total sales dip slightly from a year ago, but reported continued strength in luxury and sport

utility vehicle sales.

**Financial Services.** Credit quality remained steady, consumer borrowing was up, and no respondents reported increased delinquency rates. Contacts reported that home refinancing and purchases were up, but auto financing slowed. Commercial lenders reported strong competition.

**Construction and Real Estate.** Residential, commercial and industrial construction activity continued to increase. However, the concrete shortage has caused cutbacks in hours worked and construction delays in some regions. In some areas of the District, office occupancy and rents increased at a much slower pace than in past months as new buildings came on line. Absorption of industrial space was strong, but increased construction has some contacts concerned about overbuilding. Contacts reported that more warehouse space is being developed with office building amenities to meet the demand for lower priced back office space.

**Energy.** Oil service and machinery companies reported that their business has slowed. The decline in drilling activity previously seen in oil spread to natural gas drilling in recent weeks, with many rigs taken out of service. Natural gas inventories were as much as 25 percent higher than last year, as contacts reported storing gas in hopes that summer demand will be driven up by unseasonably warm weather. Crude oil markets remained in oversupply, and U.S. storage capacity was nearly full, with inventories 6.3 percent higher than a year ago.

**Agriculture.** Dry and hot conditions caused problems in some parts of the District. Dryland planting was delayed, as producers awaited adequate moisture. Dry pasture conditions led to culling of some cattle herds. However, planting on irrigated land was winding down, and steady irrigation allowed those crops to make good progress.

## TWELFTH DISTRICT — SAN FRANCISCO

Summary

Economic activity in the Twelfth District expanded at a solid clip in the most recent survey period, with strength in housing markets and consumer spending offsetting moderate slowing in manufacturing activity. District agricultural producers faced poor weather in California and low prices for some products. Expansion of real estate sales and construction activity was strongest in California, but activity generally remained at high levels in other parts of the District. Various types of labor remained in short supply in many areas, with additional labor market tightening reported for California. Upward price pressure was limited overall, but respondents noted significant increases in the purchase price of some services.

Business Sentiment

Respondents in general expect solid performance from the national economy and their respective regional economies during the next four quarters. Over two-thirds of respondents expect national GDP to expand at its long-run trend pace. About half expect national unemployment and inflation to remain stable, although just under 45 percent expect inflation to rise, which is a more pessimistic view of inflation prospects than reported at the beginning of the year. Two-thirds of respondents expect stronger economic growth in their regions than in the rest of the nation, with about 60 percent expecting stability in local business investment and consumer spending; however, three-quarters expect further deterioration in their region's foreign trade balance.

### Retail Trade and Services

Retail sales were robust overall. Automobiles sold well, as purchases of domestic brands were stimulated substantially by manufacturers' price breaks and financing incentives. Reports also indicated solid sales of other retail items in most areas. Inventories were at moderate levels for most retail goods throughout the District, with the notable exception of excess inventories for computers and some consumer electronics products. Although prices of imported products have fallen, strong consumer demand has kept District retail prices flat in general.

Demand for business and consumer services was strong. Sales of media and cable television services were rapid, and abundant supply kept prices stable. Recent tourist traffic and hotel occupancy have been high in Southern California; however, hotel bookings for October appear weak there, reportedly due to corporate caution regarding discretionary travel spending. Respondents noted significant cost and price increases for various services, such as health care, trucking, and eastbound ocean shipping.

### Manufacturing

District manufacturing activity expanded, but production has decelerated for some products. A respondent from Southern California reported stable sales and prices of non-ferrous metals and fabricated metal products, with moderate order backlogs. A Pacific Northwest paint manufacturer reported sales growth of 12 percent and profit growth of 15 to 18 percent over last year. In contrast, supply growth has outstripped demand growth for computer components and lumber. Although domestic demand and sales remain strong for these products, overall sales have suffered a moderating impact from the East Asian economic slowdown. Prices of computer

components continue to decline, and respondents noted lumber and timber price declines of 15 to 33 percent during the last six months. Respondents also noted a recent pickup in layoffs and reduced hiring plans by some high-tech manufacturers in the San Francisco Bay Area.

#### Agriculture and Resource-related Industries

Conditions in District agricultural markets were mixed. Early season progress of the grape and cherry crops in California's Central Valley has been hampered by heavy spring rains and unseasonably cold weather, and yields are expected to be lower than in previous years. Sale prices for wheat and potatoes remain low. Despite low prices for feeder grain, beef cattle are selling at losses of \$50 to \$150 per head in Arizona; however, meat sales to Mexico and Japan have improved.

#### Real Estate and Construction

Real estate market and construction activity was high in most areas of the District, with slight slowing in some areas but a continued pickup in all areas of California. Home sales reportedly have been at a record pace in the Seattle, Washington, area during the past six months. In contrast, construction activity and home price increases in Oregon have slowed compared to last year. Sales of single family homes remained high in Utah, but housing starts are down compared to last year, and an excess of rental units is holding rents down in Salt Lake City. Both residential and nonresidential construction and sales activity grew in all major regions of California. Real estate price and rent increases have accelerated in the state; for example, rental rates for Class A office space in San Francisco reportedly rose by 25 percent during the past six

months. Respondents in California also noted rising scarcity of construction labor, with one San Francisco Bay Area report noting that contractors are bringing labor in from other states.

### Financial Institutions

Banks reported robust loan demand and generally healthy conditions. Growth in demand for consumer loans remains slower than growth in real estate, commercial, and industrial loans. Respondents noted that stiff competition prevented improvement in loan margins and underwriting standards, and some banks have been pressured by tight labor supply and rising wages.