Summary of Commentary on Current Economic Conditions

by Federal Reserve District

July 1998
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BY FEDERAL RESERVE DISTRICT

JULY 1998
TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>SUMMARY</td>
<td>i</td>
</tr>
<tr>
<td>First District - Boston</td>
<td>I-1</td>
</tr>
<tr>
<td>Second District - New York</td>
<td>II-1</td>
</tr>
<tr>
<td>Third District - Philadelphia</td>
<td>III-1</td>
</tr>
<tr>
<td>Fourth District - Cleveland</td>
<td>IV-1</td>
</tr>
<tr>
<td>Fifth District - Richmond</td>
<td>V-1</td>
</tr>
<tr>
<td>Sixth District - Atlanta</td>
<td>VI-1</td>
</tr>
<tr>
<td>Seventh District - Chicago</td>
<td>VII-1</td>
</tr>
<tr>
<td>Eighth District - St. Louis</td>
<td>VIII-1</td>
</tr>
<tr>
<td>Ninth District - Minneapolis</td>
<td>IX-1</td>
</tr>
<tr>
<td>Tenth District - Kansas City</td>
<td>X-1</td>
</tr>
<tr>
<td>Eleventh District - Dallas</td>
<td>XI-1</td>
</tr>
<tr>
<td>Twelfth District - San Francisco</td>
<td>XII-1</td>
</tr>
</tbody>
</table>
SUMMARY*

Reports from Federal Reserve Districts generally indicated a high level of economic activity and further expansion recently, though with moderation in growth for some regions and sectors. In most Districts, retail sales were in line with retailers’ expectations, and inventories generally were characterized as balanced. Manufacturing activity remained at a high level, although the GM strike, weakening demand for exports, and general slowing in the high-tech sector damped expansion. Robust sales growth in residential and commercial real estate markets continued to fuel construction activity in most of the nation. Reports on the agricultural sector were mixed, with drought-like weather in the South and low prices for some products tempering the outlook. Financial institutions across the country continued to report healthy loan demand and generally accommodative credit conditions. Despite the high level of economic activity in recent weeks, many Districts noted that labor shortages, shipping bottlenecks, and continued weakness in East Asia were beginning to temper growth in their regions.

**Consumer Spending**

Retail sales increased in most Districts in late June and July. Boston, Cleveland, Dallas, and Minneapolis reported strong sales growth since the last report, often exceeding merchants’ expectations. Among other Districts, Chicago, Kansas City, New York, Philadelphia, and San Francisco reported steady but healthy retail sales, while reports from Atlanta and Richmond

*Prepared at the Federal Reserve Bank of San Francisco based on information collected before July 27, 1998. This document summarizes comments received from businesses and other contacts outside the Federal Reserve System and is not a commentary on the views of Federal Reserve officials.*
indicated mixed sales results. In general, consumer spending remained robust across many product lines and types of outlets. Sales were strongest for seasonal women’s and children’s apparel and big-ticket items such as motor vehicles, home furnishings, and major appliances. Retailers attributed the continued strength of retail sales to strong consumer confidence, robust home sales creating demand for complementary items, and favorable financing terms for large purchases.

For the most part, retailers reported that inventories were adequate for anticipated sales growth. However, shortfalls were noted for some products. Unseasonably hot weather caught Midwest retailers with inadequate inventories of fans and air conditioners. Declining inventories of GM products constrained sales at GM dealers and service centers across the country, but other auto dealers reportedly maintained sufficient supplies of new cars and parts.

Tourist activity picked up in recent weeks, as the summer travel season got under way. At beach resorts along the East Coast, hotel bookings and day trip traffic reportedly surpassed year-earlier levels. In Boston, increased tourist traffic from Europe offset declines in business from East Asia and contributed to the sector’s robust growth. Fires depressed tourism in much of Florida, but other parts of the Southeast attracted visitors, including those interested in riverboat gambling and Mississippi Gulf Coast casinos. In the West, tourism-related restaurant sales, car rentals, and hotel occupancy rates reportedly were strong, and attendance at parks such as Yellowstone and Mount Rushmore rose above year-earlier levels.

Manufacturing

Manufacturing activity remained at a high level in recent weeks, although growth slowed in most Districts. Boston, Chicago, Dallas, Kansas City, and St. Louis reported good growth in
non-GM related manufacturing. In Boston and Dallas, telecommunications manufacturers reported good sales gains; in Chicago strong demand for construction equipment and building materials kept producers running near capacity in recent weeks; in St. Louis, robust demand for refrigerators and other appliances induced overtime hours for some producers. In general, manufacturers reported no difficulties obtaining materials or supplies, and prices on many inputs to production were either flat or declined.

The GM strike and continued weakness in East Asia slowed manufacturing growth in many regions. In the Atlanta, Chicago, Richmond, New York, and St. Louis Districts the GM strike directly reduced manufacturing employment, idling workers at GM plants and related suppliers in these areas. The GM strike also affected electronics manufacturers in Dallas and chemical, plastic, and steel producers in Cleveland. Weakness in East Asia and increased low-cost imports continued to depress demand for a variety of U.S. products. Manufacturers reported that sales and orders for apparel and textiles, computing equipment, electronic components, industrial machinery, paper, and wood products fell in many Districts. Reports also indicated employment reductions through layoffs or attrition at some companies.

Construction and Real Estate

Construction activity and real estate markets remained robust in most parts of the nation. Home sales were characterized as strong to booming in Dallas, Kansas City, Minneapolis, Richmond, and St. Louis, and above year-earlier levels in Atlanta, Chicago, Cleveland, and San Francisco. Low mortgage interest rates continued to attract first-time buyers, fueling demand for low to moderately priced homes in many regions. Only Richmond reported concerns about an
excess supply of homes on the market; all other Districts indicated that housing inventories were low to moderate and consistent with the strong growth in home demand.

Commercial real estate demand also grew rapidly in many areas, although growth was less uniform across Districts than for residential markets. Declining vacancy rates and increasing rental prices were present in a number of cities. In Boston, low availability and limited new construction of commercial space have forced some large and growing firms to relocate to the suburbs. In Manhattan, asking rents on Class A properties have risen 25 percent since last year. In Minneapolis and St. Paul, construction of large office buildings was at its highest level in a decade. In the West, respondents from California reported that low vacancy rates for commercial office and warehouse space have prompted commercial and industrial construction in the tightest markets. Only Dallas expressed concern about over building.

Non-Financial Services

Districts reporting on the services sector indicated continued strong growth in recent weeks. In Dallas, demand for business services continued to rise, fueled by initial public offerings, mergers, and acquisitions. In San Francisco, sales of telecommunications and cable television products rose above an already high level. Cleveland reported that transportation and shipping activity remained very strong in the District, largely due to increased import volumes from East Asia. Unbalanced trade flows to and from East Asia produced an oversupply of empty containers at West Coast ports, while in East Asia new containers were being built to meet the demands of their exporters. In New York, one large retailer stocked up on holiday-season imports earlier than usual due to shipping bottlenecks at West Coast ports.
Banking and Finance

Loan demand was steady but strong in most Districts in recent weeks. However, the composition of loan demand differed among regions. Growth in loan demand in Chicago, Cleveland, Kansas City, and San Francisco was broad-based. In Philadelphia, commercial and industrial lending was flat, while consumer lending rose slightly. In Dallas, demand for home and auto loans increased, while in Richmond demand for home mortgage and commercial construction loans increased.

Overall, Districts characterized financial markets as intensely competitive, with quality borrowers receiving good terms and rates. Most Districts reported no signs of deteriorating credit quality. Cleveland, Dallas, and New York reported that loan delinquencies and writeoffs fell in recent weeks.

Agriculture and Natural Resources

Reports on agricultural conditions were mixed across the Districts. Reports from Cleveland, Chicago, Kansas City, and St. Louis highlighted generally good agricultural conditions in their regions, as favorable weather put many crops at or ahead of schedule. In the South, unseasonably hot, dry conditions distressed crops, in many cases destroying fields that could not be irrigated. These drought-like conditions also have damaged range and pasture lands.

In other Districts, reports focused on prices rather than weather. Minneapolis and San Francisco reported that low prices have reduced profitability among agricultural producers. Price declines for some commodities have been so large that producers cannot cover costs. In addition, many storage facilities remain stocked with the 1997 crops, thereby producing higher storage costs for farmers as they seek alternative facilities.
Labor Markets, Wages, and Prices

All Districts reported that labor markets remained tight in recent weeks. Labor shortages were broad-based, and some skilled workers were in especially short supply. Most areas noted problems finding information technology workers and construction tradesmen, such as framers. In addition, a number of Districts noted shortages of quality entry-level workers for retail positions; certain skilled workers such as machinists and welders; finance and banking personnel; and drivers for both short- and long-haul delivery. However, general wage increases remained limited, as employers chose to use one-time payments and merit increases to attract and retain specific types of employees.

Goods prices remained stable during the recent survey period, although there were scattered reports of increases in some services. In general, declining input prices and intense competition were credited with keeping retail prices in check. Manufacturers and retailers reportedly cannot sustain price increases in the current competitive environment.
Economic conditions are mixed in the First District although growth continues overall. While most retailers report strong sales increases, some manufacturers are seeing a slowdown in business. Price increases remain minimal but wage growth is said to be picking up a bit. Commercial real estate markets are robust in the Boston area and varied elsewhere. Investment management firms saw assets rise in June after a dip in May.

Retail and Tourism

Most retail contacts report that sales continued to show strong growth in the April through June quarter, either matching or bettering expectations for the period. Sectors of strength were upscale and mail-order apparel and office supplies and office technology products. The tourism industry is also robust. More recently (since mid-June), upscale apparel and hardware report some weakening. In all sectors, inventories are at desired levels.

Two contacts note ongoing effects of the Asian crisis: Catalog apparel sales to Asia are weak and tourist business from Asia is said to be down much more than anticipated. However, these contacts say their Asian mail order business may be bottoming out and the loss of Asian tourists is being offset by increased business from Europe.

Retailers indicate that employment is generally level, increasing only with store expansions. Wage growth has picked up a notch from the earlier 3 to 5 percent range to a 4 to 7 percent annual pace. Respondents say prices and gross margins are holding steady. The exception is hotel room rates, which continue to show sizable increases. A majority of retail contacts say significant capital expansions are either planned or in progress. Looking forward, most retailers express cautious optimism.

Manufacturing

Half of the First District manufacturers contacted indicate that recent business is up from a year ago, as compared with three-quarters of those responding seven weeks ago. Of the remaining respondents, about equal numbers report flat trends and declines. Close to half of the manufacturing sample say that inventories
are too high and/or that employment levels are being reduced through layoffs.

Telecommunications, furniture, and some appliance sales continue to increase at a rapid rate. The demand for selected aeronautics products is growing robustly, although respondents also indicate that some customers are canceling or delaying orders. Contacts manufacturing computer hardware, semiconductor equipment, industrial machinery, and automotive parts report declining sales or orders. Sluggish trends also are noted by makers of electrical components, power equipment, paper, and apparel textiles. Manufacturers of consumer items report slow growth or declines in revenues, in part because of aggressive inventory control measures by retailers.

Exporters typically indicate that sales to Asia are down substantially from a year ago, with some reporting that their business in countries such as Korea and Indonesia has virtually disappeared. Most expect that weakness in Asian economies will continue to depress their revenues in 1999.

Almost all manufacturers indicate that their materials costs are flat or down, although some mention rising costs for services. Petroleum-based products, copper, steel, some grades of lumber, as well as Asian items in general, are all reported to cost less than a year ago. Reports of higher selling prices are rare. Paper prices are said to be depressed because of increased domestic capacity and higher imports. Makers of various types of equipment express concern about their customers' ongoing demands for lower prices, given their already low margins.

Wage and salary increases are reported to be mostly in the range of 3 to 5 percent, but are 6 to 10 percent in the case of some firms heavily oriented toward research and development. Respondents indicate somewhat greater delays and upward pay pressures than previously when hiring professional, technical, and sales workers, with substantial difficulties and/or costs associated with filling engineering, information technology, and finance positions.

Commercial Real Estate

Commercial real estate markets are doing well in most of New England. The downtown Boston office market is still very tight. Vacancy rates are around 3 percent in prime buildings and around 5 percent overall. Downtown rental rates are at record high levels. Although some new development is planned, there
is currently little new construction downtown and larger firms have been forced to locate in the suburbs or beyond. The suburban Boston office market is also very strong, with vacancy rates only slightly higher than downtown. Apartment buildings are in demand, but the retail sector is weak, with higher vacancy rates and lower rental rates than last year.

Contacts report various market conditions elsewhere in New England. The Connecticut office market has improved compared to the last two years, but it still has “a long way to go” relative to where it was in the late 1980s. Office vacancy rates in the Greater Hartford area are around 18 percent while the Stamford office market is strong. The Maine commercial market, however, has not recovered so far this year. Demand for commercial space is low and banks have little confidence in the market, leading to a tight credit market and lack of new construction. The Rhode Island market is very strong, with low inventories and plans for new industrial and office construction. Moderate increases in rental rates are reported in Connecticut and Rhode Island. Contacts predict steady markets for the rest of the calendar year.

Investment Management

Assets of long-term (non-money-market) mutual funds rose in June after declining slightly in May. Stock funds saw an increase in net cash flows between May and June while bond funds had a decrease in cash inflows.

All contacts at investment management firms report that they have increased employment in recent months. Respondents indicate that they rely on hiring bonuses to attract workers and that these bonuses usually exceed 10 percent of base salary. While bonus programs are of long standing in investment management firms, some have recently expanded them into lower levels of the organization.
SECOND DISTRICT--NEW YORK

The Second District's economy continued to grow briskly since the last report. Retail sales slowed a bit in June and early July but, on balance, remain close to plan. Both retail selling prices and merchandise costs were little changed, though sizable price reductions are anticipated in early 1999. Retailers report labor shortages but not significant wage pressures. Housing markets remain firm in the New York City area and have picked up in much of upstate New York; remodeling continues to boom in northern New Jersey. Office rents continued to surge in Manhattan but have paused in most of New York City's suburbs; vacancy rates held steady at low levels in most areas.

Regional purchasing managers report that manufacturing activity continued to grow at a steady pace in June, while input prices continued to edge down. As of July 27, more than 10,000 workers in the District (mostly in western New York) were affected by the UAW-GM strike. Finally, local banks report further declines in consumer delinquency rates and continued moderate growth in loan demand.

**Consumer Spending**

Major retailers generally report that sales in the region were close to plan in June and the first three weeks of July; year-over-year comparable-store sales gains ranged from 0-9 percent for the full period. Most contacts note continued firm demand for home durables. Apparel sales are still said to be fairly brisk but less so than in April and May—a number of retailers note that warm spring weather translated into an earlier buying season for summer clothing. All contacts say that inventories were at desired levels at mid-year. One large retailer notes that shipping bottlenecks from West coast ports prompted them to stock up on imported merchandise for the year-end holiday season earlier than usual.

Retail selling prices and merchandise costs were reported to be steady, on balance, with cheaper Asian imports offset by higher prices for toiletries and certain other items. Most retailers say that the Asian crisis has had only a modest impact on the costs and prices of merchandise currently on the
shelf—mainly apparel, electronics and appliances—as well as merchandise for the upcoming Christmas season. However, a number say that they have negotiated “surprisingly” good deals for next spring’s merchandise and expect sizable price reductions in early 1999. While there were no reports of increased wage pressures, most retailers say it is increasingly difficult to staff their stores; one contact says that labor shortages have forced sharp increases in overtime costs for existing employees.

Construction & Real Estate

Housing markets in New York and New Jersey gained momentum across the board in the second quarter. Permits to build single-family homes continued to trend up in May and June, with second-quarter levels running 14 percent ahead of a year earlier. More currently, builders in northern New Jersey report that moderate to mid-priced homes have continued to draw strong traffic and sales in recent weeks, but that the high end of the market has “definitely slowed.” Separately, persistently robust demand for remodeling New Jersey’s aging housing stock has created labor shortages, drawing large numbers of “amateur remodelers” into the field, according to an industry expert.

New York State realtors report brisk sales of existing single-family homes in the second quarter, and especially in June. For the quarter overall, average selling prices rose 6 percent from a year earlier, led by double-digit gains in New York City’s northern suburbs. Unit sales rose 12 percent from a year ago statewide. Upstate New York’s chronically sluggish housing markets picked up noticeably in the second quarter, with unit home sales surging 14 percent from a year ago and prices up 4 percent.

The multi-family sector has also picked up in recent months. Permits to build apartments rebounded in the second quarter and are running slightly ahead of 1997 levels. Prices of prime Manhattan co-ops and condos also rebounded in May and June, following a dip in March and April.

Office vacancy rates across most of the New York City area held steady at low levels in the second quarter. The only areas to register further declines were lower Manhattan (from 14.6 to 13.9
percent) and Fairfield, CT (from 10.5 to 9.6 percent). Asking rents on Class A properties continued to surge at a roughly 25 percent annual rate in Lower and Midtown Manhattan, and at a 15 percent pace in Westchester. However, rents were little changed in northern NJ, Long Island and Fairfield, CT. Still, rents in Long Island and Fairfield are up roughly 10 percent from a year ago.

**Other Business Activity**

Local purchasing managers surveys indicate that the District’s manufacturing sector continued to expand at a moderate pace in June. Buffalo purchasing managers note that growth in new orders slowed in June but that both production and employment continued to expand at a steady pace. New York purchasing managers report that overall business activity grew at about the same pace as in May. Both surveys indicate that prices of material inputs were down moderately in June, though New York purchasers continue to report strong upward cost pressures for contracted services.

As of July 27, the UAW strike against General Motors was affecting an estimated 10,600 workers in the District, mostly in western New York State. In the Buffalo area, approximately 6,650 workers at GM and its major suppliers have been idled by the strike. In addition, roughly 2,350 employees at GM’s Linden, New Jersey assembly plant, 1,400 at a Rochester engine plant, and 200 at a castings plant in Massena, NY have been affected.

**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.
Business activity in the Third District remained at a high level in July, but growth appeared to have eased from the first half of the year. On balance, manufacturers reported gains, although fewer firms posted increases in orders than in previous months. Falling orders from Asia continued to affect the region’s goods-producing sector. According to merchants, retail sales held steady at a good rate, and inventories were falling. Auto sales have remained strong except for a drop in vehicle sales for strike-bound General Motors. Bank loans in the District have been steady. Tourist activity was reported to be very good throughout the District.

Looking ahead, manufacturers anticipate a lower level of activity in the second half of the year than in the first. Retailers, however, expect sales growth to resume, and auto dealers see no evidence that car buying will ease soon. Bankers forecast that demand for credit will show little or no change in the months ahead.

MANUFACTURING

Third District manufacturing activity was growing slightly in July, according to reports from the region’s goods-producing firms, but gains were much less prevalent than in the first half of the year. Continuing declines in orders from Asian customers were affecting makers of industrial goods, especially producers of building materials, chemicals, and machinery. On balance, area firms reported slight increases in shipments, new orders, and order backlogs, but all of these measures showed less strength than they did earlier in the year. Inventories decreased at
most of the plants surveyed, although some manufacturers of electronic parts and other intermediate goods reported unintended increases in inventories because of declining orders from their Asian customers.

Industrial prices for both inputs and products sold edged down, according to the firms surveyed. Manufacturers cited foreign and domestic competition as well as their own cost-cutting efforts as factors restraining prices.

Looking ahead, area manufacturers forecast slower activity in the second half of the year than in the first. They expect declines in shipments and orders, and they plan to pare employment. Although firms in the region plan to increase capital spending on balance in the second half of the year, fewer firms will be boosting outlays than during the first half.

RETAIL

Third District retailers generally reported a steady but healthy pace of sales in July. Most of the store executives contacted for this report believe the pause in month-to-month growth is mainly seasonal. They indicated that the year-to-year increase in July was good. Merchants said high consumer confidence was supporting purchases, and an increased pace of home sales was bolstering demand for home goods and appliances. Most of the retailers interviewed in July said inventories were low as they awaited shipments of fall merchandise. Merchants expect sales growth to resume with the back-to-school shopping period, although a few expressed concern that transportation problems in Asia might delay receipt of ordered goods.

Auto dealers in the region said sales continued to be strong, but General Motors dealers were suffering from a lack of supply as a result of the strike against that manufacturer. Inventories were said to be near desired levels except for GM vehicles. Manufacturers have
extended their rebate programs, and dealers expect the sales rate to remain at or near the current pace.

FINANCE

Reports from Third District bankers indicated that loan volume in the region has been virtually steady. Commercial and industrial lending has been flat. While some banks said they were booking more loans to middle market companies, others said they were losing business borrowers who have obtained nonbank financing. Consumer lending was rising slightly in July. Some bankers noted that significant amounts of consumer debt were being consolidated into refinanced home mortgages. Reports on real estate lending were mixed. Some banks were expanding residential and commercial mortgage lending, but on balance, real estate credit outstanding at banks in the region was not growing in July. Several bankers said that commercial property prices appeared to be approaching unsupportable levels, and they were becoming more selective in considering requests for construction and acquisition financing. In general, bankers expect credit demand to remain nearly steady in the second half of the year.

TOURISM

Tourist activity throughout the Third District has been strong this summer. Beach resorts in New Jersey and Delaware and mountain resorts in Pennsylvania report high hotel occupancy, robust home rentals, and healthy retail activity. Additionally, real estate agents in these areas have noticed increased interest in both existing and new summer homes, and in several areas, home sales and construction have picked up. Tourist officials also reported an increase over last year in day trips to a variety of recreational locations in the region.
General Business Conditions

The District’s economy seems to have slackened a bit, partly as a result of rising imports and the growing effects of the General Motors strike. Nevertheless, business activity remains strong overall, and labor markets are still unusually tight. Shortages of skilled workers remain a problem at many firms, especially in the communications industry. An electronics firm indicated that labor shortages there have been eased by immigration from other regions.

Temporary employment agencies in the District report that labor demand has leveled off after several months of rapid growth. Still, the demand for workers remains well above year-ago levels. Moreover, temp agencies report that a high proportion of placements become permanent hires before the standard 90-day contract has expired. Most firms report a small rise in the rate of wage growth, and retention bonuses have become common.

Collective bargaining settlements in the District reveal mixed wage patterns. About half of the union contacts report a slight increase in wage growth from this time last year, while others see wages holding steady.

Agriculture

Crop development varies throughout the District, depending on soil conditions. Dry soil is reported in the northwest Ohio and Pennsylvania regions, while flooding has been a problem in southeast Ohio and Kentucky. Nevertheless, the District’s crops are generally ahead of schedule. The condition of roughly 66% of the region’s corn and 65%
of its soybean crop is rated good to excellent—about 15 to 20 percentage points better than in 1997. And although wet weather has encouraged the spread of blue mold disease, the District’s tobacco crop is also rated as improved from last year.

In Ohio, corn plantings are down 7% from last year, acres planted in soybeans are unchanged, and winter wheat acres harvested increased 6%. Still, corn inventories are 70% above this time last year, soybeans are up 16%, and wheat stocks have risen 156%.

Construction

Residential construction has continued at a rapid pace in Ohio, while western Pennsylvania has shown signs of diminished activity. In central Ohio, new housing starts were reported up 35% between the first and second quarters, and June starts this year were 70% higher than year-earlier numbers. Commercial construction is continuing at a very strong pace throughout the District.

Construction costs are holding steady, with the exception of a slight increase in labor costs and land prices. Cost increases are somewhat higher in central Ohio, where one source indicated that building costs rose 3% to 5% overall during the first half of 1998. A few large construction companies are reported to be buying land in this region in anticipation of future building.

Industrial Activity

Manufacturing activity remains relatively strong although the GM strike and further deterioration in foreign economies appear to have taken some of the momentum out of production growth.
Steel producers report a drop in sales resulting from the GM strike and a record increase in foreign imports. These developments have combined to cause a buildup in steel inventories and to put downward pressure on steel prices.

Sales have also fallen somewhat in the chemical industry. Prices of many products are being driven down and profit margins are said to be narrowing due to increased pressure from Asian competitors. A few companies also report that raw materials prices are decreasing. Some chemicals and plastic producers also report a drop-off in sales due to the GM strike.

The transportation and shipping industry remains very strong. Ports and railroads see increased volumes related to the recent strength in imports. Trucking companies are also reporting an increase in business from year-ago levels. Some firms expressed concern that the impact of the GM strike, whose influence on the industry has been only minor until now, is increasingly being felt in the supplier network.

**Consumer Spending**

The retail sector continues to show strength, with some discount stores noting double-digit increases in sales year-over-year. Other retailers report high single-digit sales growth. Among the various retail categories, women's apparel, especially casual wear and sportswear, has shown substantially improved sales growth. Sales of men's apparel, however, has softened relative to a year ago.

The furniture category saw modest sales increases, as did home electronics. Strength in the electronics segment came from sales of digital satellite systems, home office equipment, and major appliances. Audio equipment has seen a sales decline.
Inventories for every category of retailer appear to be “on plan.” Owing to sales strength and store growth, retail outlets continue to add staff. Most report “no more difficulty than usual” in acquiring personnel. Retail prices remain flat, with the exception of electronics, where prices have been declining.

After posting record sales volumes in June, District auto dealers note a drop in new-car sales in July. GM dealers indicate that inventories have eroded and sales have dropped dramatically as a result. Other dealers, however, remain generally optimistic about continued sales strength. Used vehicle sales have been relatively stable, although prices at auctions are reportedly rising again after many months of decline.

**Banking and Finance**

Lending activity in the District is strong for both commercial and consumer loans, and demand for the latter category is continuing to strengthen. However, mortgage refinancing activity has moderated somewhat following many months of strong gains. Consumer delinquencies have improved, and commercial delinquencies are holding at a very low level.

Competition for borrowers is still vigorous in the District. The spread between borrowing and lending rates continues to narrow.
Overview: Fifth District economic activity continued to grow at a moderate pace in the weeks since our last report. Retail sector growth slowed noticeably from its rapid rate earlier in the year, pulled lower in part by softer consumer-durables sales. In contrast, growth in the manufacturing sector edged up because of solid domestic demand, and the service sector expanded at a more rapid clip. Real estate activity and bank lending remained strong throughout most of the District. Labor markets stayed very tight and employers continued to scramble for qualified workers, but wage growth remained generally modest. Prices of goods and services were little changed. In agriculture, hot and dry weather stressed crops and reduced yield prospects.

Retail: Retail sales grew more slowly, and firms lowered their staffing levels in recent weeks. Among merchandise categories consumer electronics and hardware and lumber sales were softer. While some retailers trimmed employee numbers to reduce labor costs, tight labor markets left other employers unable to fully staff their stores. The manager of a hardware store in Columbia, S.C., expressed frustration at high employee turnover and has recently purchased material-handling equipment to reduce his labor needs. In contrast, automobile sales were strong in June and July, although some General Motors (GM) dealers reported low inventories because of the United Auto Workers (UAW) strike. Wage growth in the retail sector moderated somewhat, and of those contacts who reported wage increases, several said that the higher wages were straining their profit margins.

Services: Service sector revenues grew at a slightly quicker pace since our last report. Hotels reported a sharp uptick in both business and vacation stays. The Richmond, Va., airport indicated that air passenger traffic set a record in June. Employment rose in recent weeks, but the gains were more modest than in our last report. Wage growth eased a bit, while prices for most services were generally little changed; higher hotel prices were a notable exception. Looking forward, service providers anticipate increased demand for their services through the end of the year.

Manufacturing: District manufacturing activity strengthened somewhat in recent weeks following a sluggish June. Shipments and new orders growth bounced back for most goods-producing industries. However, employment slipped lower, particularly at textile and apparel
plants. Several textile mills recently announced job cuts because of continued economic problems in Asia. A contact at one North Carolina textile mill said that these problems were “getting worse quickly.” In contrast, shipments of industrial machinery and electronic equipment grew more quickly.

The UAW strike against GM is having an impact in the Fifth District. Nearly 2,700 workers at a GM plant and 300 at a GM parts supplier in Baltimore, Md., have been laid off. In North Carolina, a producer of fabrics used in GM automobiles said that his company had asked its employees to take vacations on a rotating schedule in order to avoid layoffs. In South Carolina, some auto parts producers have begun altering their work schedules and eliminating overtime until a settlement is reached.

**Finance:** District loan officers reported strong and steady demand for bank loans. Continued low interest rates and a strong economy have underpinned brisk mortgage lending. Commercial lending was boosted in some areas by increased construction loans. Vigorous competition for commercial accounts persists; in the words of a Charleston, S.C., banker there is simply “too much money chasing too few deals.” A few bankers we talked with said that more intense competition was resulting in “looser” loan covenants in the industry.

**Real Estate:** Residential realtors described home sales as “very strong” to “excellent” across most of the District. Less expensive homes sold particularly well, in part because low interest rates continued to make houses more affordable to first-time buyers. In some areas, however, contacts said that the supply of new homes rose; a West Virginia realtor noted that speculative building had caused the normal six-month supply of homes to balloon to a ten-month supply. Homebuilders reported that building permits and housing starts were “holding steady” at generally high levels. Labor and materials costs rose only modestly, despite widespread shortages of skilled workers. House framers were in extremely short supply and one builder said that framers could “name their price.”

Commercial real estate activity remained at a high level, although some contacts noted evidence of a slowdown. A North Carolina realtor described the market as “static compared to before” with “no major swings one way or another.” In contrast, a South Carolina contact said that the market there was just “humming along,” and a District of Columbia contact characterized growth in that market as “brisk,” driven by the need for more office space for law
firms and telecommunications companies. Realtors’ outlooks for commercial real estate activity were mixed, but most expected no change in market conditions in coming months.

**Tourism:** Tourist activity continued to strengthen in June and the first three weeks of July. Bookings for the Fourth of July holiday were somewhat stronger than those a year ago; one resort operator on North Carolina’s Outer Banks credited unusually pleasant weather for increased business during the holiday. Looking forward, contacts at hotels and resorts expected tourist activity to remain strong through the end of the year.

**Labor Markets:** Strong demand for workers persisted throughout the District in almost all industries. Contacts at employment agencies said that employers were seeking help in many job categories, but particularly for administrative assistants with computer knowledge. Employers continued to comment on the disappointing quality of job applicants; a printer in North Carolina said that the quality and productivity of new hires had declined in recent months and that “many work a week or two and then fail to return.” A Columbia, S.C., lumber retailer echoed the view of many employers with his comment that the low quality of available workers is “what you would expect with a two percent unemployment rate.” Despite labor market tightness, wage pressures remained mild; several contacts expressed the general sentiment that competitive pressures severely limited the wage increases they could offer.

**Agriculture:** Agricultural analysts report that despite some scattered showers in recent days, unusually hot, dry conditions across most of the District had stressed crops, especially corn which is in its pollinating and ear-filling stages. In South Carolina, the heat and drought has hit crops particularly hard; some fields there were considered a total loss. In other areas, producers of high-value crops such as tobacco and vegetables turned to irrigation to maintain their yields. Across the District, yield prospects for many crops have diminished in the last few weeks and agricultural analysts said that continued heat and drought could quickly broaden crop losses.
Summary: According to most District contacts, growth remained steady in the Southeast and the outlook remains positive. Retail sales continued to exceed last year’s levels in June and inventories remain balanced. Single-family home sales and construction are also running above last year’s figures, and commercial real estate markets remain healthy. The manufacturing sector has slowed somewhat from our last report. Recent fires in Florida dampened travel to the state, while along the District’s Gulf Coast, tourism has increased. Bankers report moderate loan demand. Tight labor markets remain a problem for many regional employers, but wage increases are not widespread. Most contacts continue to report that prices are stable because of the competitive environment.

Consumer Spending: According to retail contacts, sales during June were up slightly compared with a year ago, while sales results in early July were mixed. As in our last report, most retailers said that recent sales had met their expectations, although a notable minority was disappointed with the latest results. Most merchants continue to report balanced inventories and expect third quarter sales will exceed the prior year’s level slightly.

Construction: Once again, reports from real estate contacts indicate that home sales during June were above year-ago levels in most areas of the District. Most District builders reported that new home construction was up slightly during June and early July with no signs of overbuilding. Commercial real estate markets remain healthy throughout much of the region. Office development generally continues at a strong pace; however, several markets are showing some signs of slowing. The industrial market remains stable in most areas, and retail markets
remain healthy in most areas. Multifamily construction continues at a strong pace despite rising vacancy rates in several key markets.

**Manufacturing:** The factory sector appears to have weakened a bit, with slowing current output and new orders, when compared with our most recent beige book report. Margins continued to be squeezed for regional apparel producers because of offshore competition; these companies are reportedly restricting inventories because of cheap imports flooding the market. The General Motors strike is adversely affecting parts suppliers in Alabama and Tennessee, as well as all but one of the District assembly plants. Several paper mills in Alabama have opted for downtime because of high inventories and decreasing sales. More positively, shipyards in New Orleans are thriving with large new contracts. Several chemical plants are also expanding in Louisiana. Shipments are increasing for producers of electronic and electrical equipment.

**Tourism and Business Travel:** Fires in Florida have resulted in a temporary setback for the state’s important tourism and hospitality industry. Some hoteliers in Miami reportedly were discounting rooms and offering attractive travel packages to draw visitors. The smoke from the fires forced the closure of a major highway for four days and the cancellation of a major stock car race at Daytona Beach, resulting in an estimated economic loss of $300 million to the Daytona area. Theme parks remained packed in the immediate Orlando area and hotels there had few vacancies. One contact noted that some hotels and motels near the fires reported booming business, thanks to the many firefighters they were housing. In other parts of the District, riverboat gambling revenues are up from a year ago in Louisiana, and more hotel rooms are about to come online in New Orleans. Labor shortages are constraining the continued expansion of casinos along the Mississippi Gulf Coast.
Financial: Overall loan demand has continued its moderate pace of expansion throughout the District. Consumer, commercial, and automobile loan activity remain healthy, and mortgage demand and refinancing activity continue to be brisk.

Wages and Prices: Although contacts note some escalation in wage and benefit costs, competition continues to restrain passing on costs to consumers. Pressure in the technology field is especially intense because of worker shortages. Production at some Tennessee companies is reportedly growing more slowly than projected because they can not fill certain positions, and many hotel operators there have resorted to recruiting employees from other countries under special temporary visas. Benefits such as stock options, extended vacation plans, and bonuses are increasingly being used to recruit and retain employees. Productivity enhancements have about reached a peak for some firms contacted, and profits are expected to begin to suffer.

Goods prices remain stable with a few exceptions. In the oil service sector, daily rental rates for supply vessels have plummeted. Paper prices continue to suffer because of competition and lackluster sales.

Agriculture: A drought throughout the Southeast has caused a great deal of distress to crops despite recent scattered rains. Hay and corn for livestock feed have been in short supply throughout the region. To date, the drought has cost $405 million in lost gross farm receipts in Georgia, with cotton, hay, peanuts, corn, and tobacco being the hardest hit sectors. In Florida, the drought has thus far cost the state $175 million in farm revenue and about $300 million in commercial timber. Corn yield in Alabama is expected to be 50 to 70 percent of the normal level; the heat has also lowered dairy production by about 20 percent and has stunted chicken growth.
Summary. The Seventh District economy remained quite strong in June and July, though growth was hampered by strikes against General Motors Corporation. The strikes led to the company shutting down nearly all of its operations in the region, idling tens of thousands of workers. However, most contacts outside the auto industry reported very limited effects from the strikes. Consumer spending picked up in July after slower-than-expected sales results in June. Exceptional strength in the construction industry was rippling through virtually every segment of the economy. Consumers were buying home furnishings and appliances to stock their new homes and the region's steel and construction equipment producers were running near capacity. Lending activity remained brisk in June and July, in large part due to very strong home sales. Labor markets remained much tighter in the District than for the nation as a whole, despite the heavy concentration of GM and its suppliers in the region. Hog prices dropped below the break-even point for many pork producers and grain prices were pushed downward by the prospect of a large fall harvest.

Consumer spending. Overall retail sales in July were in line with industry expectations after slower-than-expected June sales results. Reports by individual merchants were mixed, however, because some retailers were not adequately stocked to meet the demand for air conditioners, fans, etc., due to warmer-than-expected weather. Women's and children's apparel were most often cited as selling very well while sales of fall merchandise got off to a slow start. Strong home sales continued to boost sales of complementary items, such as furniture, electronics, lawn and garden, appliances, and home improvement items. There were no reports of unwanted inventory accumulation and promotional activities were virtually unchanged from the same period last year. For most of the District's retailers, there has been little or no effect so far from the auto strikes. One national department store chain reported that, in contrast to sales gains elsewhere, sales were down markedly in the immediate area of the strikes (Flint and surrounding areas); and some restaurants/lounges and convenience stores in that area were also negatively impacted. Sales of new light vehicles at GM dealerships were down considerably due to a lack of inventory, and parts shortages resulting from the strikes were beginning to hamper their service business. Light vehicle sales remained strong for the region's other automakers, despite a slight pullback in the use of incentives. On average, the industry's level of incentive spending decreased recently although the pullback was tempered by the competing goal of increasing market share. Automakers were
VII-2

concentrating on increasing market share through fleet sales. The shortage of new vehicles has been driving up prices on some used GM vehicles.

**Housing/construction.** Overall construction activity remained very robust in June and July, the impact of which has rippled through the rest of the economy. Strength in existing home sales continued to surprise some realtors, with year-over-year unit sales growth in the double digits. Sales of new homes did not fare as well. Though still strong, builders across the District indicated that new home sales had softened somewhat in June and July. Several contacts suggested that the exceptional sales pace early in the year may have borrowed some from June and July sales. However, there were no reports of unexpected inventory buildup or increased use of incentives to move new housing units. As in our last report, business construction remained very robust with the exceptional strength making it very difficult to find construction workers in many markets. The overall strength in housing and construction activity could be felt in virtually every economic sector from consumer spending to the region's manufacturing sector--where producers of construction equipment, steel, and building materials were all running near capacity.

**Manufacturing.** Manufacturing activity remained very high in the District, although overall growth was slowed by the auto strikes in June and July. Production of light vehicles in the District dipped expectedly, but the slowdown was due entirely to the auto strikes. Other automakers reported continued high levels of production, with light vehicle sales remaining strong and inventories in good shape on fast selling models, but slightly high for some of the slower selling lines. The auto strikes curtailed production at some of the region's steel factories. Due to "just in time" inventory control, suppliers of steel to GM had a strong incentive to cut production immediately, but one contact indicated that those suppliers will quickly resume normal production once the strikes are settled. Steel prices decreased slightly as inventories built up due to the strikes and as imports from Asia accelerated. Producers of construction equipment and heavy trucks continued to run at or near capacity with strong demand and desirable to slightly lean inventory levels. Demand for agricultural equipment softened noticeably as a result of declining food commodity prices. In addition, another of the region's manufacturing industries (paper) was reporting adverse effects from the economic malaise in Asia.

**Banking/finance.** Lending activity generally slowed in June and July though growth remained positive and "acceptable." The commercial lending market was described by one banker as "hot as a pistol." Lenders in Michigan and Indiana expressed concern that prolonged auto strikes
could erode asset quality on loans to some of the automaker’s suppliers. Only a small percentage of suppliers to the industry are exclusive to GM, however, and to date there were no reports of asset deterioration resulting from the strikes. Competition in the commercial real estate segment was leading to a few deals that left some analysts “scratching their heads.” Strong sales of new and existing homes continued to bolster the consumer side of lending. Though largely past the recent boom, refinancing activity remained robust and one contact indicated that another 10-15 basis point drop in the rate on 30-year fixed rate mortgages could lead to another wave of refinancing activity. Competition continued to squeeze margins, but increased fee income—especially mortgage underwriting fees—was boosting profits. Many bankers indicated that strong earnings are being used to shore up loan loss reserves, limiting their exposure in the event of an economic downturn. Overall asset quality remained very good according to most contacts.

**Labor markets.** Labor markets in the District remained tighter than for the nation as a whole, despite the labor strife at GM. The region’s unemployment rate was nearly a full percentage point below the national average in June, and labor markets showed few signs of developing slack in July. Some auto suppliers and dealers were reluctant to lay off workers, despite the strike-related slowdown, for fear of losing them to other employers. A District trucking and warehousing firm reported continued difficulty in finding and retaining quality drivers. A staffing services contact in central Indiana indicated that the firm had more applicants and fewer permanent hire orders from mid-June to late July. This contact suggested that these developments, and several requests by previous applicants to re-open their files, indicated some softening of demand for labor in the area. Contacts most frequently cited information technology and construction workers as being in short supply. There were no new reports of intensifying general wage pressures, with District employers preferring to use targeted wage increases and one-time bonuses to attract and retain workers.

**Agriculture.** For many hog producers, hog prices have fallen below break-even levels as a result of weaker-than-expected exports to Asian markets, increased output, and large competing supplies of beef and chicken. In contrast, strong demand for milkfat-based products, such as butter and ice cream, firmed up milk prices for dairy farmers. Much of the critical pollination period for corn occurred in July (rather than August) due to the early spring planting. Generally favorable weather conditions and a lack of any serious problems contributed to a decline in cash and futures prices for both corn and soybeans. The well-being of the corn and soybean crop is somewhat variable, with conditions relatively better in Iowa and Wisconsin than other District states.
Summary

Economic activity remains robust throughout the District. Contacts are reporting growth in both demand and sales and expect more of the same in the near future. Tight labor markets still prevail. Fallout from the UAW strike against GM is being felt at suppliers and other firms around the District. Several District employers report double-digit increases in health insurance costs for their employees. Real estate markets, both residential and commercial, are strong: Sales and prices are up. Real estate loans at large District banks, however, are down, which, together with consumer loans, have pulled down the total number of loans outstanding. The District's wheat crop looks to be significantly below last year's production.

Manufacturing and Other Business Activity

Most contacts continue to report strong growth and remain optimistic about economic prospects in the near future. Shortages of skilled workers, especially construction workers, are still hampering production gains at some firms. With real estate markets booming, this labor shortage is straining builders' ability to keep up with housing demand. But for contractors, the real estate market is a dream. As one contact remarked, "If you can't make money in today's market as a contractor, you'll never make it."

The furniture and household appliance industries are being carried along with the real estate wave. Demand for high-end furniture has grown, but to some degree at the expense of lower end merchandise. Demand for refrigerators has also increased; it is being met with overtime. Meanwhile, contacts at various metals firms are reporting sales growth in the range of 10 percent over a year earlier.
Labor disputes have also taken their toll on activity. Numerous GM suppliers around the District are reporting layoffs because of the UAW strike. This is the first time that some of these firms have had to layoff workers because of a GM strike. Unrelated to the GM strike, a maker of filters in Louisville closed its plant after management and UAW workers, on strike since April 1, failed to reach an agreement. And 530 Steelworkers are striking against an aluminum smelting firm in western Kentucky. The workers struck in late June; there has been no contract since the union was formed last summer.

**Labor Compensation**

District firms generally continue to report a ratcheting up of wage rates. To some extent, this remains most evident for high-skilled positions. Moreover, entry-level wages in many areas and at a cross-section of industries are reportedly well above the federal minimum wage. An increasing number of contacts are reporting outsized increases in their cost structure due to health insurance premiums. Increases in excess of 10 percent compared with a year earlier are not uncommon. In response, some firms have implemented more cost sharing with their employees.

**Real Estate and Construction**

Residential real estate markets remain strong throughout the District. Agents continue to report rising prices and a surge in sales of both new and existing homes. In many metropolitan areas, year-over-year median sales prices are up between 6 and 14 percent. Sales of homes priced between $120,000 and $175,000 are particularly strong, while the market for homes priced above $400,000 appears to be softening moderately. New residential construction tapered off somewhat in May from April, with only five of the District's 12 metro areas posting an increase in building permits. Year-to-date permits, however, are up in nine metro areas from a year earlier, with Little Rock and Louisville posting healthy 25 percent increases. Agents also report vibrant commercial real estate markets.
Construction of new apartment complexes, particularly upscale, luxury apartments, is on the rise in several areas.

**Banking and Finance**

Total loans on the books of a sample of large District banks declined 2.7 percent in the two months between mid-May and mid-July. A large decline in real estate loans of 5.7 percent was mostly responsible for the downturn in outstanding loans. Consumer loans also declined, but by a much smaller 1.2 percent. Commercial and industrial lending, on the other hand, continues to expand, rising 2.8 percent over the period. One year ago, C& I loans rose 1.6 percent during the same two-month period.

**Agriculture and Natural Resources**

District row crops are reported to be in good condition in most areas, although some nonirrigated crops in southern parts of the District have recently deteriorated because of sparse rainfall and hot temperatures. Overall, though, the recent hot and dry weather throughout most of the District appears not to have harmed row crops yet significantly. Initial USDA projections indicate that the 1998 wheat production should be down by an average of nearly 10 percent in all District states except Arkansas, where increased plantings and a modest uptick in yields are expected to boost production by nearly 17 percent. In the remaining states, fewer planted acres and, in some instances, marked yield declines are expected to be the norm. Moreover, initial reports from a few areas indicate some deterioration in the quality of the harvested wheat crop. Poultry producers, however, have had higher-than-average death losses because of power outages during the heat spell. District farmers report that the drought-like conditions in parts of the Southeast have spurred an increase in the demand for hay.
Growth continues to predominate in most sectors of the Ninth District economy. But ill winds, especially from Asia, are increasingly retarding the pace of growth. General retailing, autos, tourism and construction are strong. Real estate markets are very active in both residential and commercial categories. Unemployment rates remain very low, and labor markets show continuing symptoms of tightness.

Manufacturing output, while still high overall, is beginning to slacken, especially in those products or firms with substantial Asian exposure. Manufacturing exports are down on a year-over-year basis. The natural resource sectors, particularly agriculture, mining and energy development, face low prices, and drilling and mining activity is faltering. Reports of upward pressure on overall compensation are widespread, despite data showing only moderate increases in direct, cash compensation.

**Real estate and construction**

"Sizzling home market continues," headlines a Minneapolis article reporting double-digit increases in sales of existing homes for the first half of 1998 compared to a year ago. Realtors also report strong activity in office, commercial and light industrial space.

Construction is similarly booming. Residential building permits for the Minneapolis-St. Paul area were up 38 percent in June and 22 percent for the year, again compared to the same periods in 1997. In growing regional centers such as Rochester, Minn., Sioux Falls, S.D., Eau Claire Wis., and in the Minneapolis-St. Paul metropolitan area, strong residential building is matched by robust commercial work. The downtown areas of both Minneapolis and St. Paul show the fastest pace of large office building projects in a decade. Public and private heavy construction reportedly is up 5 percent to 11 percent in Minnesota and the Dakotas through May, compared to 1997, marking a sixth consecutive season of strong growth.

**Manufacturing**

"We have the bad luck to have the wrong stuff going to the wrong places," comments one Minnesota trade expert in explaining a 9.5 percent drop in first quarter exports compared to a year earlier. The largest declines were to Japan, Canada and Thailand. A major Minnesota manufacturer also announced plans to cut 4,000 positions worldwide, largely through attrition, in response to weaker international earnings and flat domestic demand. A computer component manufacturer will close a 120-employee factory in South Dakota and move production to Mexico. A St. Paul based financial printing firm announced the closing of three plants, all located in other districts, and the layoff of 400 employees in a move unrelated to any foreign events.

Nevertheless, many other manufacturers report good sales, and manufacturing employment
grew through June — in Minnesota it was some 2 percent above a year ago. And a computer component manufacturer announced planned expansions for the Eau Claire area that will add more than 1,000 employees over the next two years. Moreover, publicly traded firms that are not dependent on trade with Asia continue to report generally strong revenue growth.

Agriculture
Farming is the most troubled sector of the district economy. In terms of output, prospects are good in most areas. Crop conditions are generally favorable, and late spring rains in Montana alleviated earlier worries about drought. Output of wheat, corn and soybeans should be at or above five-year averages for states as a whole. Specific regions face less favorable conditions. Areas of Minnesota and North Dakota which had severe plant disease problems over several years expect similar damage this year to wheat and barley. Dry conditions in grazing areas this spring reduced hay yields and will force some ranchers to buy hay sooner or later.

Prices rather than crop conditions are the main concern. Wheat growers are under the greatest pressure in terms of output price relative to costs, but corn and soybean prices have also fallen to a point where many producers will find it difficult to pay all costs. Farm bankers report that increasing proportions of customers have reached debt limits. Many bankers require higher levels of collateral than a year ago. Farm implement dealers report extremely slow sales.

Returns to hog raising improved somewhat in late spring, but remain unfavorable. Many cattle feeders lost money on animals fed over the past winter and spring, but may face somewhat more profitable feeder cattle and feed prices for animals put on feed this year.

One area of concern is adequacy of transportation and storage facilities for the new crop. Much on-farm and commercial storage remains tied up with the 1997 crop. Principal railroads have warned that they may not be able to move as much grain as elevators think necessary to accommodate the new crop. Work on improvised storage facilities has begun in many areas.

Energy and mining
Oil and gas drilling has stabilized at somewhat more than half of the rate experienced at the height of the boom two years ago. Oil output remains above the levels that prevailed throughout most of the decade as a result of the wells completed in the last 30 months. New leasing and seismic exploration are reportedly very slow. Gold mining apparently continues to contract. Iron mine output projections for 1998 remain largely unchanged and about equal to 1997 levels.

Consumer spending and tourism
“Sales in June and July have been very good,” reports a Montana auto dealer who had experienced somewhat slower demand earlier in the year. Vehicle sales are strong for most district dealers with the exception of those located in agriculture-dependent areas.
General consumer spending continues robust across many product lines. National and regional chains based in the district report strong sales. Mall managers describe good traffic; one comments that successful movies this year are helping business by bringing large crowds into her mall.

After a long period of sluggishness, prospects of the tourist sector are positive. Summer tourism showed strong growth for June and July compared to a year earlier. According to a chamber of commerce in northern Wisconsin, tourism businesses are reporting strong sales. A tourism office in Duluth, Minn., reports about a 9 percent increase for the area. In South Dakota, attendance at Badlands and Mount Rushmore parks is up 53 percent and 16 percent respectively for June compared to a year earlier, while motel occupancy for June is up 6 percent. "All reports that we've been hearing are good," says an official in Montana where visits to Glacier and Yellowstone parks were up 22 percent and 7 percent respectively in June compared to 1997.

Employment, wages and prices, wages and prices

"Shortage of workers hits region hard," and "Workers Wanted," are headlines to recent stories describing the tight labor markets in west-central Wisconsin, where unemployment rates are in the mid 2 percent range. While hourly earnings in manufacturing and other available data on wages and salaries show only moderate increases in the 3 percent range over year-earlier levels, anecdotal reports of higher increases in cash and noncash compensation are extremely widespread. A major credit card processor in South Dakota announced increases in its general wage structure of up to 12 percent for some workers as well as increased flexibility in work scheduling. Total employment is up strongly in most urban areas and unemployment rates in the mid to low 2 percent range are common. Montana and Michigan's Upper Peninsula are exceptions, showing higher levels of unemployment and fewer subjective indications of worker shortages.

Prices for consumer goods as well as commodities and intermediate goods show little increase. Low gasoline prices and low prices for crop and livestock products are undoubtedly helping to hold down the general price level, but manufacturers and retailers continue to report difficulty in making any price increase stick in a competitive environment.
Overview. The district economy continued to grow moderately last month, with no major signs of easing. Retail sales maintained a strong momentum into the summer, construction activity improved further, and manufacturing activity remained fairly strong. An exception was energy activity, which was flat. In the farm economy, corn and soybean crops enjoyed good conditions, while pasture conditions were poor. Operators of cattle feedlots and hog producers continued to lose money. Labor markets in much of the district remained very tight, with more evidence of wage pressures than in the recent past. Prices edged down at the retail level and declined slightly for most manufacturing materials. In contrast, prices were up slightly for some construction materials.

Retail Sales. Retailers reported a slight increase in sales last month, improving on the robust performance of the previous period. Most respondents expect sales to improve considerably over the next three months. Inventories expanded modestly last month, and retailers were generally satisfied with current stocks. Inventories in the near future are likely to expand to match seasonal growth in demand. Automobile dealers reported good performance last month as sales of sport utility vehicles and light trucks remained strong. Total sales were moderately higher than a year ago. Inventories edged up once again, with the exception of GM vehicles. Most dealers were generally satisfied with current stock levels but plan to trim inventories in the coming months after seasonally stronger summer sales subside.

Manufacturing. Manufacturing activity remained fairly strong last month with plants operating at high levels of capacity. More difficulties with obtaining materials were reported compared with the last survey period. Only a few respondents reported slight increases in lead
times. Inventories were generally unchanged. Although most managers remained unsatisfied with current stock levels, they plan no major changes in the near future.

**Housing.** Builders reported that housing starts remained high last month and were well above year ago levels. Although many builders expect additional gains in construction activity in the coming months, they are less optimistic than in the last survey. Sales of new homes were up again last month, leaving inventories of unsold new homes at low to moderate levels. According to mortgage lenders, demand last month was generally unchanged but remained well above year-ago levels. Home purchases accounted for almost half of mortgage activity. Lenders expect mortgage demand to stay strong over the next three months as rates remain low.

**Banking.** Bankers reported that loans and deposits both rose last month, leaving loan-deposit ratios unchanged. Commercial and industrial loans, home mortgage loans, and home equity loans increased, while other loan categories were little changed. Increases in demand deposits 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.** Despite a fall in prices, district energy remained fairly steady last month, after a marginal improvement in the previous period. Natural gas prices fell, though not by as much as in May. Crude oil prices fell in June to their lowest levels since 1986. The district rig count was practically flat in June but was 18.7 percent lower than a year ago.

**Agriculture.** The district’s corn and soybean crops in June were in good condition and crops were developing on schedule in most parts of the district owing to favorable weather
conditions. In the cattle industry, pasture conditions continued to be poor and some cow-calf producers may liquidate herds if rainfall is not received within the next month. Some district banks remained concerned that cattle feedlot operators were continuing to lose money, although losses have slowed recently. Hog producers were also losing money, and many small hog producers have already liquidated their herds. Larger producers have not trimmed their herds. Area bankers reported that in spite of high farmland prices the debt-to-equity ratio on farmland loans remained stable. Producers have been using cash reserves built up over the past two years to finance purchases of land.

**Wages and Prices.** Labor markets remained very tight last month in much of the district, with somewhat more evidence of wage pressures than in previous reports. Retailers complained of persistent problems hiring entry-level workers, while manufacturers reported increased labor shortages of skilled workers, especially welders and machinists. With construction activity strong, builders faced significant labor shortages and reported a severe scarcity of select trades such as framers. Additionally, most respondents reported difficulties in hiring and maintaining workers in the information technology field. As a result of persistently tight labor markets, there were more reports of wage pressures than in previous surveys. Wage pressures were more concentrated in construction activity and areas requiring skilled workers in general, such as information technology employees. Prices were steady to slightly down at the retail level, and prices for most manufacturing materials continued to decline. Prices of some construction materials, such as cement and sheetrock, were up slightly last month, and builders expect them to remain high over the next three months. Retailers expect no major price changes in the coming months.
Over the past six weeks, Eleventh District economic activity expanded at about the same modest pace reported in the last Beige Book. Oil service and machinery contacts reported further slowing. Agricultural conditions have deteriorated due to the drought. Manufacturing activity grew at the same pace as reported in the last Beige Book. Demand for business services continued to increase overall, with few contacts reporting slowing sales growth. Credit quality and consumer borrowing increased slightly. Retailers reported continued strong sales growth. Real estate and construction activity continued to expand at a brisk pace.

Prices. Most prices were unchanged or lower. Notable exceptions were those for real estate and some construction materials. Apartment rents and home prices continued to rise, but increases in office rents slowed. Prices also rose for electricity, industrial motors, specialized apparel and business services. Prices were unchanged for most apparel, crude oil, heating oil, natural gas, retail gasoline, plastic resins, steel, cement bricks, air and surface cargo and food. Prices declined for lumber, telecommunications equipment, liner board, semiconductors, memory chips, electronic components, wholesale gasoline, rig rates, base petrochemicals, and aluminum. Lower prices for Asian goods were reported as keeping retail prices down.

More contacts reported that labor shortages were leading to rising wages. Wages increased for workers in telecommunications manufacturing, truck and air transport, and business services, and for skilled workers in general. Business service respondents said that the rising wages were putting pressure on profits. Wages in the apparel, paper, food and lumber industries were unchanged, but contacts reported upward pressure in non-border areas.

Manufacturing. Manufacturing activity grew at the same pace as reported in the last Beige Book. Sales of lumber, some metals, electronic components, semiconductors, DRAM
chips, chemicals and heating oil were down. Contacts reported that weak Asian demand had contributed to increased domestic supplies of lumber, aluminum, and chemicals. Electronics manufacturers reported weak sales due to the GM strike and slower oil and gas exploration activity. Despite the increased demand from the summer driving season, high refinery production levels kept gasoline inventories high and put downward pressure on refiners' margins. Contacts reported stable sales of boxes, food and concrete, but one box manufacturer said Christmas shipping of boxes started a month later than the usual May start. Sales of telecommunications equipment, some specialized semiconductors, apparel, brick, and gasoline were up. Telecommunications equipment contacts were starting to see their sales pick up with resumed investment following the MCI-Worldcom merger.

**Services.** Demand for business services continued to rise, fueled by initial public offerings, mergers, takeovers, and work for manufacturing businesses near the border. Some business service contacts reported lower sales due to the drought, the GM strike and weakness in the semiconductor industry. Temporary staffing contacts reported the tight labor market resulted in more unfilled orders and lower than expected sales. Transportation services contacts reported loads increased strongly for passenger airlines, moderately for trucking companies and slightly for air cargo shippers. For the rail industry, increased coal shipments offset smaller grain shipments caused by the drought and weak Asian demand for grain.

**Retail Sales.** Retailers reported continued strong growth in sales, except for sporting goods. Contacts expect sales to remain strong—but with downward price pressure from Asian imports. One retailer said that wholesale prices in the spring of 1999 could be 2 percent to 3 percent lower than this year. Auto dealers reported increased sales compared to a year earlier.

**Financial Services.** Credit quality and consumer borrowing increased slightly, and several contacts reported declining loan delinquency and writeoffs. Demand for home and auto
loans continued to increase. Increased building and commercial activity offset some of the
drought-induced weakness in lending by rural institutions. Contacts reported competition
continued to hold down interest rates on commercial loans.

**Construction and Real Estate.** Real estate and construction activity continued to
expand at a brisk pace over the past six weeks. Home construction "exploded," nearing record
levels, in part due to delayed starts earlier in the year. One contact expected the low
inventories of new and existing homes to contribute to continued strength in home building.
Other contacts were concerned that there may be too much new construction in the office and
multifamily markets. Preleasing of office buildings under construction fell. Contacts expected
apartment construction over the next year to outpace absorption, leading to a slight decline in
the currently strong occupancy rates.

**Energy.** Contacts reported continued slowing in both gas and oil drilling. Over the past
several weeks, the U.S. rig count fell from 860 to 810 and was down from a recent peak of
1019 in December. Continued weakness in onshore drilling and recent reductions in
exploration in the Gulf of Mexico led to lowered rig day-rates and some layoffs. Although the
hot weather translated into strong demand for natural gas by electric utilities, natural gas
inventories remained at least 25% above year-earlier levels.

**Agriculture.** Agricultural conditions deteriorated as extremely hot temperatures
stressed crops and livestock. Most areas remained very dry, despite some scattered rainfall.
While irrigated crops were doing well, water use was high. Some crops have been damaged by
grasshoppers. Water rationing impaired production in South Texas. Range and pasture
conditions continued to decline.
TWELFTH DISTRICT—SAN FRANCISCO

Summary

Reports from Beige Book contacts generally indicated a solid pace of overall economic activity in the recent survey period, though with moderation in growth for some sectors. Retailers reported healthy sales growth, and District service providers noted continued high demand for their products. Manufacturing activity cooled in recent weeks, damped by declining export demand and a general slowing in the high-tech sector. District agricultural producers noted that rising inventories and falling prices have squeezed profit margins on many commodities and forced some producers to operate at a loss. Strong residential and commercial real estate demand continued to fuel construction activity in the District. Financial conditions remained favorable throughout the District, and competition for quality borrowers intensified. Respondents continued to be concerned about the tightness of labor markets in their regions.

Business Sentiment

District respondents expect a solid but tempered performance from the national economy and their respective regional economies in the coming year. About two-thirds of the respondents expect U.S. GDP growth to slow to its long-run average pace, leaving the national unemployment rate at or near its current level. Most respondents expect inflation to remain stable, although roughly one-third anticipate an increase in inflation in coming quarters. Nearly all respondents expect economic growth in their region to outpace growth in the national economy over the next year. Respondents are most optimistic about the strength of business investment and consumer spending in their areas. East Asia continues to affect import and
export expectations in the District—more than 75 percent of District respondents anticipate further deterioration in their region’s foreign trade balance.

Retail Trade and Services

Retailers in most District states reported solid sales growth in recent weeks. Sales were strongest for big-ticket items such as cars, home furnishings, and major appliances, as customers took advantage of seasonal discounting and favorable financing terms. Overall, District retailers reported adequate inventory levels and few problems obtaining merchandise from suppliers. The notable exceptions were for GM products. Respondents reported shortages of “hot selling” GM cars and trucks and most GM replacement parts. One respondent noted that delivery times on parts have doubled in recent weeks and backorders have reached ten times their normal level. Retailers throughout the District noted that stiff competition and falling import prices have kept retail prices down, despite healthy consumer demand and rising labor and occupancy costs.

Service industry respondents in most District states continued to report robust growth. In California and the Pacific Northwest, demand for telecommunications and cable television services remained high, outstripping supply in some cases and putting pressure on prices. Tourism-related restaurant sales, car rentals, and hotel occupancy rates were healthy throughout the District, boosted by the beginning of the summer travel season. Unbalanced trade flows to and from East Asia continue to affect District ports and eastbound shipping prices. Empty shipping containers are piling up at ports and warehouses throughout the District, while in Asia new containers are being built to meet the demands of their exporters.
Manufacturing

Reports on District manufacturing activity were mixed. Contacts noted that the East Asian slowdown continues to affect both current production and future orders of a diverse set of products including industrial machinery and equipment, electronic components, wood products, processed foods, and aircraft. Manufacturers of high-tech equipment reported that, although the industry has slowed markedly in recent months, growth remains positive and most companies continue to prosper. In general, District manufacturers reported no difficulties obtaining materials or supplies, few capacity constraints, and declining prices on key inputs such as energy. Finding skilled employees remained a major concern among respondents from the manufacturing sector, particularly those in Portland, Seattle, and the San Francisco Bay Area.

Agriculture and Resource-Related Industries

District agricultural producers have grown concerned in recent weeks. Although weather conditions improved in most District states, farmers and ranchers reported difficulty selling inventory and maintaining profitability. Despite lower than average yields on many fruits and vegetables, inventories remain high, driving product prices down and storage prices up. Respondents noted that price declines for some commodities have been so large that producers cannot cover production costs. Reports from ranchers indicate further price declines on feeder cattle and excess supplies of poultry and pork. Respondents throughout the District reported significant difficulties obtaining seasonal agricultural workers.

Real Estate and Construction

Residential real estate and construction activity reportedly was strong in most District states. Demand for single-family homes continued to grow in Arizona, California, and Nevada
and picked up significantly in Alaska. In Washington, the Puget Sound area posted strong sales of both new and existing homes. Housing demand and residential construction cooled further in Oregon and Utah, although activity remains at a high level. In many areas of the District, the residential construction sector is operating at capacity. Labor and materials shortages reportedly have become binding constraints against more rapid construction growth in Alaska, Arizona, Nevada, and California's Central Valley.

Commercial construction activity also was strong in most parts of the District. Throughout California, respondents reported that commercial office and warehouse space is hard to find and commercial and industrial construction is rising. In Utah, light-rail and freeway construction continue to boost non-residential construction, which already was active with commercial building. A respondent from Alaska noted that commercial construction activity is at its highest level since the mid-1980s. High commercial and residential construction activity in many District states has prompted a “bidding war” for labor and materials, reportedly driving up some project costs by as much as 40 percent.

Financial Institutions

Twelfth District banking conditions remained favorable in recent weeks. Respondents reported that bank capital and liquidity were ample, and competition for loans remained intense, with quality borrowers receiving excellent terms and rates. Respondents also noted that low interest rates have led to increased loan volume and encouraged refinancing on all types of real estate. Throughout the industry, shortages of qualified workers continued to be a primary concern.