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Summary of Commentary on _____

Current Economic Conditions

by Federal Reserve District

October 1998

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SUMMARY¹

Summary. District reports suggested that the pace of economic expansion moderated in September and October amid signs of slowing in some sectors. Retail sales were mostly at or below merchants' expectations, but there were only scattered reports of unanticipated inventory accumulation. Real estate and construction activity remained generally robust, especially in residential markets, but most Districts reported that more stringent credit standards were a factor slowing commercial real estate activity. Manufacturing activity continued at relatively high levels, but was the sector most often cited as showing signs of softening. Lending activity varied by region, with demand remaining strong, although many lenders were reported to be tightening standards somewhat, mostly on business loans. Labor markets remained very tight in most Districts, although demand for workers in manufacturing industries was softening in some areas. Crop conditions varied across Districts as the fall harvest progressed. Low commodity prices and adverse weather conditions in some areas were increasing concerns among farmers and agricultural banks. Upward pressure on most wages remained subdued. Prices at the retail level were little changed, while producers' prices for intermediate inputs were generally flat to down.

Virtually all Districts reported that businesses and consumers remained cautious about the economic outlook. Boston and St. Louis noted increasing concern while Philadelphia, Atlanta, and Minneapolis reported a modestly improved outlook.

Consumer spending/tourism. Most Districts reported slowing retail sales growth with results coming in at or slightly below most merchants' expectations. However, the Boston, Cleveland, Richmond, and San Francisco reports suggested that sales gains were moderate to strong. Discounters were reported to be outperforming other retailers in some Districts. Light vehicle sales were picking up in the Cleveland, Richmond, and Chicago Districts while softening

¹Prepared at the Federal Reserve Bank of Chicago and based on information collected before October 26, 1998. This document summarizes comments received from business and other contacts outside the Federal Reserve and is not a commentary on the views of Federal Reserve officials.

in Philadelphia, Dallas, and Kansas City. Sales of other big-ticket items (such as jewelry, home furnishings, electronics, appliances, etc.) were strong in many Districts, but mixed in Chicago and soft in San Francisco. Apparel sales picked up as the weather cooled in the Chicago District but remained slow in New York and San Francisco. Retailers in most areas reported satisfactory inventory levels, but there were a few reports of inventory overhangs. However, only the Chicago District noted greater-than-usual promotional activity to clear them. Tourism and travel spending was reported to be very strong in the Boston, Minneapolis, and San Francisco Districts, but slowed in the Atlanta region where Hurricane Georges and weakness in Latin American economies hindered travel.

Construction/real estate. Residential building and sales continued strong, but generally flat, in most of the country. The Richmond District reported an increase in new housing activity, while Atlanta and Kansas City suggested some softening. New York indicated general strength with pockets of weakness, particularly in the New York City area. The pattern was similar for existing home sales, with most regions reporting solid, but flat, sales volumes. The Chicago District noted exceptional activity in September, with no signs of the typical seasonal slowdown in October. Atlanta and Richmond said sales of existing homes had softened somewhat recently. The Chicago and Richmond Districts reported some weakness in sales of higher priced homes, the former attributing this to recent volatility in financial markets.

Nonresidential construction activity, both private and public, remained strong in most Districts, although there were signs of softening in commercial real estate markets. St. Louis and Richmond reported noticeable decreases in speculative building. A contact in the Richmond District attributed the weakness, in part, to the lack of credit, adding that “spec” development that wasn’t already underway had come to a halt. Minneapolis, on the other hand, was reporting the strongest office market in over a decade.

Manufacturing. Reports indicate that growth in overall manufacturing activity slowed in 11 of the 12 Districts. St. Louis was the only District not reporting overall softening, with its strength due largely to production of transportation equipment. Three-quarters of the Districts

indicated that economic turmoil abroad, especially in East Asia, was at least partially responsible for softening demand. Steel producers in the Cleveland, Atlanta, and Chicago regions attributed a significant slowdown to a dramatic increase in imported steel over the late summer and early fall. Producers of semiconductors and other high-tech equipment noted decreased shipments in half of the Districts. Agricultural equipment makers cut fourth-quarter output schedules, but producers of other heavy equipment continued to run near capacity. Production in the auto industry picked up amid efforts to restock strike-depleted inventories. Increased shipments of personal computers were noted by the Dallas and San Francisco Districts.

Banking. Business lending activity was mixed across Districts, while low interest rates buoyed consumer and home mortgage lending activity. Philadelphia, Cleveland, and St. Louis reported increasing business lending, while Atlanta, Minneapolis, and Kansas City noted declines. Most regions continued to experience strong demand for business loans, but increased uncertainty about economic conditions made lenders more cautious. Tightening of credit terms or standards on business loans was reported in two-thirds of the Districts, with the majority of them pointing to a less favorable economic outlook as justification. Commercial real estate was the segment most often targeted for tightening though there were a few reports of tightening on merger and acquisition lending. Contacts in the Philadelphia, Cleveland, and San Francisco Districts suggested that there was a pickup in loan demand from borrowers who typically would have gone through other channels such as capital and equity markets.

Consumer lending activity was reportedly strong in most Districts, especially in New York, Chicago, and Kansas City. Cleveland noted a further softening of consumer lending conditions from their last report. Mortgage originations and refinancing activity picked up as mortgage interest rates fell. Asset quality on consumer loans was generally unchanged from the last Beige Book report, and only two Districts--New York and Kansas City--reported tightening standards, albeit modest.

Concerns at agricultural banks continued as low commodity prices persisted. Chicago reported that after a few good years most farmers could withstand the low prices this year, but could falter if soft prices continued well into next year. Banks in the Minneapolis District

continued to be very concerned, as some banks sought to diversify by branching into urban markets. Lenders in the Kansas City District noted a deterioration in their agricultural portfolios from last year.

Labor markets, wages, and prices. Labor markets remained very tight in most Districts, but there were few new reports of intensifying wage pressures. Dallas was the only District to indicate “marked” slackening in some labor market segments. Reports suggested that labor market tightness continued to hamper business creation and expansion plans in some areas. Contacts in the Atlanta District reported difficulty in finding mid-level managers for positions that were downsized just a few years ago. Shortages of workers persisted in most areas, but appeared to be no more pronounced than in previous reports. Information technology, skilled trades, and construction workers were most often cited as being in short supply.

Reflecting a general softening in the industrial sector, manufacturing employment reportedly declined in nearly half the Districts, while St. Louis and Kansas City indicated increased hiring in some segments. The Boston and New York Districts noted layoffs and bonus reductions in the financial services industry due to recent volatility in financial markets. By contrast, the Chicago District noted little effect.

Upward pressure on wages and prices remained generally subdued, according to most District reports. Cleveland, however, noted that temporary help agencies had increased wages in order to fill positions in the last three months. Contacts in the Atlanta District suggested that, while wages continued to go up in parts of the region, employers were absorbing most of the added costs and not passing them along in the form of higher prices. Most producers’ input prices declined while output prices generally remained flat. The general tone of District reports suggests little, if any, change in retail price pressures.

Agriculture. Agricultural conditions varied widely across regions and concern about deterioration in financial conditions in the industry increased. The fall harvest generally progressed at or ahead of normal in the Midwestern Districts. Chicago, Cleveland, St. Louis, and Minneapolis reported that corn and soybean yields and quality were good to excellent.

However, crop conditions in the southern and western U.S. were decidedly less favorable. Dallas noted that conditions remained very difficult, with the combination of bad weather, high costs, and low prices leaving many agricultural operations in serious financial shape. St. Louis observed that weather conditions in the southern part of its District had adversely affected crop conditions. San Francisco reported that poor yields and a late harvest adversely affected the California industry.

With the exception of dairy producers, who were benefitting from low feed costs and near record product prices, the industry was facing low prices that resulted from the squeeze generated by a substantial carryover, large new crop production, and a marked cutback in demand from foreign markets, Asia in particular. Contacts in the Dallas District noted that as many as 25 percent of the region's producers would discontinue production over the next year. Kansas City observed that the downturn in the farm economy was also being felt by rural "Main Street" businesses, and farm equipment dealers and manufacturers.

Other Natural Resources. Activity in the extractive industries continued weak. Kansas City noted that an increase in oil prices in September had resulted in a marginal gain in energy activity; however, declining prices in October were expected to reverse that move. Dallas observed that energy activity continued to decline in that region and that oil directed drilling was near an all-time low. Severe weather conditions in the Gulf of Mexico forced temporary abandonment of some drilling rigs, but damage was less than expected. Minneapolis noted that an increase in steel imports forced the curtailment of activity in some Minnesota iron mines.

FIRST DISTRICT-BOSTON

Economic conditions in the First District are increasingly mixed. Retail contacts generally report moderate to strong sales growth, but some sectors began to soften in September or October.

Manufacturers are less upbeat; about half are still seeing increases in business, but a growing range of industries are weakening. Prices continue to be steady. Selected labor markets are still said to be tight, but both manufacturers and mutual fund firms are reducing hiring. Retailers are cutting back on capital spending. Firms say they are planning for 1999 with increasing caution.

Retail

Most retail contacts report moderate to strong sales growth in the period from July through early October, about in line with expectations. Sectors of strength are mail-order apparel, office supplies and office technology products, building materials and supplies, hardware, and tourism. One retailer selling apparel in Asia reports weak, but no longer declining, demand. By contrast, upscale retailers and sellers of graphic products report a slowdown in growth in September or early October. An upscale retailer blamed stock market uncertainty, in part, for the decrease in sales. Inventories are generally at desired levels.

Base employment is said to be holding steady and increasing only with store expansion. Most retailers hope to hire the normal range of workers for the holiday season, but expect to experience difficulty in recruiting. Many contacts report wage growth in the 5 to 8 percent range, an increase from earlier in the year, as they attempt to retain valued help in a tight labor market. Most respondents say prices and gross margins are holding steady. One exception is hotel room rates, which continue to rise; these contacts say they don't expect rates to continue rising in 1999.

Only a few retail respondents plan to expand operations. Of these, two-thirds are expanding only to complete projects well under way, while re-evaluating projects planned for a year or more out.

Looking forward, most retail contacts express optimism about the final quarter of 1998, but they are more pessimistic regarding 1999 and beyond. Half of the contacts say they expect a recession

within the next 12 to 18 months, while the other half expect a slowdown in growth.

Manufacturing

About one-half of the First District manufacturers contacted indicate that recent business is up from a year ago. Segments with sales growth include biotech products, printed matter and paper goods, and office equipment. However, weakness is emerging or continuing in a substantial range of industries. Demand from the semiconductor industry reportedly is down almost 50 percent from a year ago. Furniture orders, which had been growing strongly, now appear to be trailing off. A paper mill reports a flurry of order cancellations in the past month. Manufacturers of automotive components and consumer items also report falling sales.

Sales to Asia continue to be considerably lower than a year ago; exporters typically expect further weakness, although one firm is encouraged by a considerable decline in retail inventories in Asia. Some firms also mention steep declines in business in Russia and Brazil.

Almost all manufacturers indicate that both their materials costs and their selling prices are either stable or falling. The few increases in selling prices are in the range of 1 to 3 percent. Paper prices are said to be falling at a double-digit rate and companies are getting bargains on items from Asia. Because of a reduced crop this year, cotton prices are expected to increase in coming months.

Most respondents' capital spending plans are unchanged, although a few are either cutting or scrutinizing expenditures. About two-thirds of contacts have either cut employment recently or made downward adjustments in hours. Although layoffs have become more common in general, companies report continued difficulties hiring for telemarketing, information technology, and engineering positions (but some easing in the case of hardware engineers). A few companies located in areas with very low unemployment are having trouble filling production jobs. Average pay increases are running 3 to 6 percent.

Most respondents express some degree of caution about sales or profits in 1999, especially in light of lingering problems in foreign nations and stock market volatility. A couple of representatives remarked

that financing has become more costly or less available, although the majority do not cite the availability of bank credit as an additional impediment.

Residential Real Estate

Contacts in real estate report that recent changes in the stock market are making lenders and potential home buyers somewhat more cautious. Banks are said to have become more conservative about lending money for new construction, virtually eliminating any speculative building. Nonetheless, conditions in the market for existing homes have not changed much. The residential market continues to be strong in most of New England, with year-to-date sales increasing moderately relative to last year. Massachusetts is still robust, with considerable sales growth in the summer for single-family homes, especially in desirable communities, as well as a very active market for condominiums. In contrast, the inner-city Hartford market is still depressed, with large inventories of condominiums and multi-family houses. Markets in Vermont, Rhode Island, and New Hampshire have been very active during the past few months, *but with no or very small price increases*. Contacts expect their markets to remain active through the end of the year if interest rates stay low.

Investment management

Total assets in stock mutual funds declined 16 percent between July and August of 1998. The declines represented mostly falling share prices, as net cash outflows amounted to only 0.4 percent of assets. Furthermore, contacts indicate that the net cash outflows were caused mostly by significant declines in new sales rather than by redemptions. Respondents report cash flow into stock funds was again positive in September. The assets of bond funds were mostly unchanged in August. Respondents at investment management firms in the First District report some easing of previously reported labor shortages, partly because of hiring cutbacks in response to uncertain market conditions.

SECOND DISTRICT--NEW YORK

Economic growth in the District has slowed further since the last report, with softening in a number of sectors. Retail sales were generally below plan in September but on or close to plan in October, with discounters out-performing department store chains. While housing markets remain firm in much of the District, pockets of weakness have emerged in and near New York City. The office rental market remains tight; however, sales and prices of commercial properties have fallen in recent weeks, with one industry expert citing a “severe credit crunch” in commercial real estate.

While the region’s labor market remains firm, prospects for job and income losses on Wall Street appear to have dampened consumer confidence. Regional surveys of purchasing managers suggest continued weakness in manufacturing activity in September, but fairly sturdy growth in non-manufacturing sectors. Finally, local banks report a pickup in loan demand—largely for home mortgages—and steady to declining delinquency rates.

Consumer Spending

Retailers report that sales in the region were below plan in September but on or close to plan in the first three weeks of October. Department store chains report that same-store sales were little changed from a year ago, while discounters report gains of 5-9 percent. Much of the weakness was in apparel, with some retailers citing mild weather. New York State’s one-week tax abatement on clothing and shoes (Sept. 1-7) reportedly had no discernible impact on sales in the region. Most contacts note that home goods continued to perform well.

Major retailers report they are unaffected by shipping bottlenecks. Contacts say that inventories are generally “in good shape”; two major chains note some overhang in fall apparel but expect it to move as cold weather arrives. Retail selling prices and merchandise costs were generally steady, and

are expected to remain so through the upcoming holiday season. However, price reductions are widely anticipated on Spring 1999 merchandise—mainly imported apparel and electronics. Retailers report steady wage pressures, but express concern about adequate staffing for the upcoming holiday season.

Construction & Real Estate

Some pockets of weakness have emerged in the District's generally strong housing market in recent weeks. New York State realtors report that sales of existing single-family homes remained sturdy in September, with sales rising 11 percent ahead of a year earlier and prices rising 8.3 percent. Homebuilders in northern New Jersey report generally firm market conditions in September and early October, but a clear softening in demand in areas adjacent to New York City, with some buyers pulling out of contracts. Similarly, a major Manhattan brokerage notes a marked decline in buyer traffic, sales volume, and prices of co-ops and condos in September—especially at the high end of the market; activity has picked up in October, while prices held steady. On both sides of the Hudson, weakness is attributed primarily to concern about Wall Street. In terms of financing, builders report that they have largely shifted from REITs to more traditional lenders (banks and insurers) but have not seen any decline in credit availability. They also report that buyers are not having problems getting mortgages.

The commercial real estate rental market remains exceptionally tight, though the sales market has cooled, largely due to financing problems. One industry expert in northern New Jersey notes a "severe credit crunch" in commercial real estate, affecting the sales market for office, industrial and retail properties, and possibly hindering future construction activity. In Manhattan, the sales market for office properties softened considerably in September; however, office rents continued to rise at a more than 25 percent annual rate and vacancy rates held fairly steady at low levels in August and September. Office markets in NYC's suburbs were mixed; in Long Island and northern New Jersey,

vacancy rates declined in the third quarter, while rents rose modestly. In the northern suburbs (Westchester and Fairfield), vacancy rates edged up, while rents were little changed.

In western New York State, contacts report that commercial construction was quite strong in 1998, but some firms anticipate some weakening in 1999. Still, one major supplier of construction equipment attributed its strong sales to the "highway bill" and expects business to stay strong in 1999.

Other Business Activity

Reports on job market conditions and consumer confidence are mixed. A large New York City employment agency reports that, aside from a hiring slump at international banks, the metro area's labor market remains tight. Merrill Lynch announced that it will cut 2,000 jobs in the New York City area, including 500 consultants; further layoffs and reductions in bonuses are expected at most major Wall Street firms. The three major television networks also announced jobs cuts and/or salary freezes. On the other hand, a major computer software firm recently announced plans to add 1,000 jobs at its Long Island headquarters over the next year. Consumer confidence in the Middle Atlantic region—New York, New Jersey, Pennsylvania—fell to its lowest level of the year in October. However, confidence in the Albany area (tracked by a local academic institute) rose to a cyclical high in the third quarter.

Local purchasing managers surveys suggest that manufacturing activity has softened relative to other sectors in September. Buffalo manufacturers report some acceleration in production activity in September, but a downturn in both new orders and employment. Rochester purchasers note continued weakness in the local manufacturing sector, but a pickup in activity in nonmanufacturing sectors. New York purchasing managers report a modest pickup in manufacturing and continued sturdy growth in other sectors. In general, prices paid for commodities continued to decline, while prices for contracted services continued to rise.

New York City's hotel occupancy rate, after seasonal adjustment, fell to a three-year low in the third quarter, though it is still at a high level. There have been no reports of real disappointment about revenue lost as a result of the Yankees' sweep in the World Series.

Financial Developments

According to the latest survey of senior loan officers at small and medium sized banks in the District—conducted in mid-October—the overall demand for loans increased over the past two months, driven by strong demand for residential mortgages. Refinancing activity also increased, which most bankers attribute to the recent cut in interest rates. While reports of financing problems have mainly come from commercial and industrial borrowers, bankers report that they tightened their credit standards on all categories of loans and grew less inclined to lend on net: only 6 percent reported a higher willingness to lend—the lowest percentage in at least four years.

Interest rates on all types of loans declined over the last two months. Residential loan rates were lowered almost universally—by 93 percent of the banks surveyed. Average deposit interest rates decreased over the past two months, with 71 percent of the bankers surveyed reporting lower rates. Delinquency rates on consumer loans and mortgages fell, suggesting continued improvement in the quality of credit; delinquency rates on commercial and industrial loans held steady.

THIRD DISTRICT - PHILADELPHIA

Business conditions in the Third District appeared to be steady in most sectors in October, although there were reports of slowing activity in some industries. Manufacturers reported a slight decline in demand compared to the prior month. Retailers indicated that sales were steady from September into mid-October; however, auto dealers reported a drop in sales. Bankers generally indicated that loan volume outstanding has been level. Some banks have increased business lending in response to a rise in loan requests, but several have reduced their participation in commercial real estate financing.

The outlook among firms contacted for this report is for very modest improvement, at best, during the balance of this year and in 1999. Manufacturers anticipate only nominal gains in shipments. Retailers forecast just slight improvement in sales for the rest of the year. Bankers expect the growth rate of economic activity in the region to ease and loan demand to slacken accordingly. On a positive note, business contacts expect employment to remain fairly healthy.

MANUFACTURING

Reports from Third District manufacturers in October suggested that conditions remain stalled. New orders at area plants were flat, on balance, and order backlogs declined. However, more firms reported increases in shipments than decreases, and inventories have fallen overall. Producers of chemicals, business machines, and electronic equipment continued to suffer from falling demand from Asian markets, but producers of steel and concrete products said increased funding of highway repair and construction in the region has boosted their sales.

Manufacturers expect some improvement in new orders for their products in the next six months, although the number of firms forecasting increased shipments only slightly exceeds the number expecting decreases. On balance, firms surveyed in October plan marginal increases in employment and capital spending.

A large majority of firms reported that both input costs and prices they charge for their own products have been steady, but about one in six said industrial prices in general had eased from the prior month. Firms competing with imports noted downward pressure on prices, and some other companies said domestic capacity in their industries was high and price competition was keen.

RETAIL

Third District retailers generally indicated that sales have been steady in the first half of October compared to September. Although some stores reported that sales of home furnishings and hard goods have been holding up well, most of the retailers contacted for this report said sales were somewhat below plan. In general, discount stores were posting better results than other types of stores. Overall, merchants said their inventories were at satisfactory levels. Some merchants noted that they have been cautious in ordering goods, and they intend to limit increases in inventories.

Store executives in the region expect to post just slight year-over-year gains in the fiscal fourth quarter, which includes the Christmas shopping period. Some said a continuation of uncertainty in financial markets would have a noticeable negative effect on sales, especially of big-ticket items and luxury goods.

Auto dealers said sales have declined in the past few weeks. The drop was attributed to

both supply and demand factors. Some dealers reported that the availability of new models has not met their needs. Other dealers said a reduction in manufacturers' incentives and a lack of consumer interest in some new model offerings have damped demand this fall compared to the summer. Despite the slower pace of sales, dealers generally indicated that their inventories were not excessive.

FINANCE

Most of the Third District bankers surveyed in mid-October said loan volumes outstanding at their institutions have been steady in recent weeks. A few noted some slight increases in business borrowing. Several bankers said that large companies have approached banks for credit in lieu of public offerings of debt or equity. Applications for bank credit for commercial real estate projects were also said to have increased, but bankers said willingness to provide financing for this sector has declined in both public markets and among depository institutions. Demand for credit among middle-market firms was described as steady.

Consumer loan volumes outstanding were generally described as steady in the region. Some banks noted heavy residential mortgage refinancing activity, but there have been only minimal increases in the value of mortgage loans outstanding at the institutions contacted for this report.

Bankers expect loan demand to ease in the months immediately ahead. They forecast a decline in demand for commercial and industrial credit as a result of an overall slowing in business expansion in the region which they anticipate for next year. Demand for consumer credit is expected to pick up seasonally at year-end but is not expected to be strong in 1999.

IV-1

FOURTH DISTRICT - CLEVELAND

General Conditions

Business activity in the District remains good overall, although a softening in the industrial sector has been seen. Price increases are still slight, despite reports of a continued acceleration in wage growth.

Temporary employment agencies in the District report labor shortages in practically all occupations. In the District's southern regions, many customer service and general labor jobs remain unfilled, while in the northern regions, skilled industrial workers are in short supply.

In an attempt to fill vacant positions, employers have increased wages and shown some flexibility in work hours: Every agency surveyed indicates at least one upward wage adjustment in the past three months, mostly in the 3% to 4% range. A few agencies report that employers have become more willing to negotiate hours with potential employees.

Union sources also report a shortage of skilled workers, although wage growth in this sector is thought to have been traded off for greater job security in response to increased outsourcing of jobs to foreign locations. Moreover, several contacts note a move toward longer-term contracts, some as long as 5 years.

Agriculture

Favorable weather conditions during the harvest season have benefited the District's agricultural sector. Crop production is generally above last year's high levels,

IV-2

and crop quality is good. However, crop inventories, including corn, soybeans, and wheat, are up substantially from this time last year; wheat stocks in particular are reported to be at their highest level in several decades. As a result, the prices of virtually all the District's major crops have dropped sharply since a year ago.

Tobacco production in the District is expected to be down about 5% from last year and the crop's quality has declined somewhat.

Business Activity

Reports from the construction industry indicate brisk activity, especially in central Ohio. Building materials costs remain flat, but a further run-up in land prices has been noted, mostly in the central Ohio region where speculative construction activity is also seen. District builders indicate a tight labor market for skilled craftsmen, such as carpenters, and a slight increase in wages.

Industrial activity has been moderating, especially in materials areas such as steel, where a drop-off in exports and a surge in imports has put downward pressure on prices. Sales at chemical companies have been flat or slightly down from last year. Several of the region's chemical companies are being adversely affected by economic weakness in Asia, which has reportedly produced worldwide overcapacity for the industry. Prices in this industry are generally holding steady, however.

Capital goods producers note a recent slowing in the growth rate of orders and production. Still, business activity in this sector remains good and domestic demand is strong. Heavy-truck manufacturing shows continued vigorous growth in orders and production. Backlogs in this industry remain at historical highs. Auto-related production

IV-3

is also advancing at a pace that is rated good or higher. However, a flattening in construction equipment orders has been observed and agricultural equipment manufacturing has seen a sharp fall-off in orders and production.

International freight companies report a huge backlog of goods waiting to be shipped out of Asia. Moreover, shipping companies note little demand from abroad, and the shipment of empty containers back to Asia has prompted surcharges on some Asian shipments. Similar accounts come from the domestic transportation industry. A contact in the railroad industry reported a recent increase in container traffic traveling by rail and greater numbers of empty containers moving west.

Consumer Spending

After a slow September, the District's retail sector has shown strength in October, up between 3% and 5% over the same sales period last year. Moreover, national retailers indicate that spending in the Fourth District has exceeded U.S. averages. Sales of seasonal items, electronics, housewares, and furniture have been especially improved between months.

Retail inventories are said to be "on plan," with sales projections and prices holding about even. As retail outlets add staff in preparation for the holiday shopping season, many report worse-than-normal trouble finding workers.

Auto dealers say that September sales of new vehicles were up from August and remained at or above their September 1997 pace. However, special dealer incentives may be contributing to recent sales strength.

Banking and Finance

Demand for consumer loans has softened since the last District report, although mortgage refinancing activity is still high and there has been a significant increase in demand for commercial loans. Delinquencies remain flat in virtually every loan category. A few banks report a slightly wider spread between borrowing and lending rates, although none report any change in lending attitudes.

Nonbank credit, however, is thought to have become more scarce since August. In particular, liquidity in the high-yield credit market has “dried up.” This development is reported to have made it more difficult for firms to finance certain mergers and acquisitions, pushing some borrowers to equity-related financing.

FIFTH DISTRICT – RICHMOND

Overview: Fifth District economic activity advanced at a moderate pace in recent weeks, although individual sectors' performances were mixed. Service sector activity grew solidly in October and retail activity picked up as big-ticket sales rebounded from a summer lull. Manufacturing, however, remained in the doldrums with some producers continuing to lose ground to foreign competitors. Bankers were a little more cautious, but lending activity remained strong. In real estate, residential activity advanced at a slower pace and commercial activity cooled in some markets as concerns over credit availability grew. Wage growth moderated in the retail sector, but was little changed in manufacturing and services. Price growth remained subdued in the retail and services sectors, while modest price declines were reported in a number of manufacturing industries.

Retail: Retail sales grew at a faster pace since our last report, fueled by a revival in shopper traffic and big-ticket sales. District automobile sales were strong in recent weeks; one GM dealer reported that "sales should continue to pick up now that we will be able to build back our inventories." Most big-ticket retailers indicated that their customers were searching longer and negotiating lower prices; despite this, they reported solid sales. Looking forward, retailers expected that their sales growth would not slow appreciably in coming months even though they anticipated a more cautious mood for consumers. A hardware retailer in Virginia said that "we continue to look for signs of a slowdown, but as yet they haven't materialized."

Services: Service sector revenues grew in October after two months of declines. Service firms noted that recent fluctuations in financial markets have not yet damped demand but have created a "less confident market" with "more cautious consumers." After edging lower in previous months, service sector employment grew at a modest pace in October while wage growth remained constant. Price increases for services remained moderate in recent weeks.

Manufacturing: District manufacturing activity weakened further in recent weeks. Shipments and new orders edged lower and the average workweek declined. Production declined in the textiles and apparel, furniture, chemicals, and transportation equipment industries. Several textile producers attributed the declines to the continued

economic and financial problems abroad; their export sales shrank further, and imports have eroded their domestic market share. A furniture producer in North Carolina stated that his sales had been dropping since August and that foreign buyers were scarce at October's Furniture Market in High Point, N.C. Manufacturing wage growth was little changed in October. Prices declined in the textiles, apparel, and furniture industries.

Evidence of declining exports also appeared at District ports. A contact at the Port of Baltimore said that imports far exceeded exports in September and a representative of the ports of Wilmington and Morehead City, N.C., noted that they were accumulating empty cargo containers because of fewer exports.

Finance: District loan officers reported that lending activity picked up since our last report as declining interest rates sparked refinancings of business loans and home mortgages. A number of lenders, however, noted that they had become more cautious in evaluating loan applicants in light of an anticipated slowdown in the economy, although lending volume had not yet been appreciably affected. A loan officer in Richmond, Va., explained that although he was "looking harder at deals," loans that "passed muster six weeks ago" generally "still pass muster today." A Charleston, S.C., banker conveyed the sentiment of several lenders with his comment that the loan committee at his bank did not want to see exceptions to loan policy in the current economic environment.

Real Estate: Residential real estate activity continued to expand at a solid pace in October, but the rate of expansion was cooling in many areas of the District. Major real estate markets in Washington, D.C., Virginia, and North Carolina, were described as slowing in recent weeks. Housing starts, however, remained strong despite a pullback in speculative building. According to builders, less expensive starter homes were selling well as lower interest rates have made them an attractive alternative to renting. A South Carolina builder noted that condominiums and townhouses were "selling like hotcakes." Prices of homes advanced modestly in most areas, but edged lower in western Virginia and West Virginia.

Commercial real estate activity in the Fifth District slowed in recent weeks. In Richmond, Va., Motorola announced an indefinite delay in construction of its multi-billion dollar production facility. In the Washington, D.C., area contacts expressed growing concerns about credit availability. One realtor there described a "backing off of

commercial real estate prices” due to a “decline in rental rates because landlords are worried about having empty space.” He also noted a doubling of landlord concessions in recent weeks for projects that are expected to be completed within the next few years. Another Washington, D.C., contact said that all speculative development that wasn’t already under construction had come to a halt, which he attributed to market weakness and lack of credit availability.

Tourism: Tourist activity was mixed in October. Although hotels in coastal areas reported that their business weakened somewhat, resorts in mountain areas reported generally stronger activity. A contact on North Carolina’s Outer Banks said that tourist activity had lost momentum in the aftermath of Hurricanes Bonnie and Danielle. In contrast, a hotelier at a popular mountain resort in West Virginia said that convention business at his resort was much stronger than a year ago. In addition, a source at a time-sharing resort in the Virginia mountains reported a recent pickup in the construction of new units there and said that developers had expanded their future construction plans. Looking ahead six months, most District contacts expected tourist activity to remain steady.

Temporary Employment: The demand for temporary workers continued to be robust across the District in recent weeks. Service-sector workers, especially those with computer skills, remained in strong demand. Manufacturing firms, however, recruited fewer workers. Several agencies noted a slowdown in the number of “temp-to-perm” workers as employers have become more reluctant to commit to full-time employment. Contacts reported little or no change in the wages that their placements received and did not foresee substantial changes in wages over the next few months.

Agriculture: Fall harvesting and planting activity was brisk across most of the District. Dry weather and near normal temperatures were favorable for cotton and soybean harvesting. In Virginia and the Carolinas, cotton harvest progress was above average as was soybean harvesting activity in Maryland and West Virginia. In many areas, farmers began planting small grain crops despite the continued low levels of soil moisture. Rainfall will be needed in coming weeks to allow these crops to germinate properly.

SIXTH DISTRICT - ATLANTA

Summary: The pace of current economic activity weakened slightly in the Sixth District since the last Beige Book, according to business contacts, but the outlook remained positive. Merchants' sales were somewhat above those of a year ago, and expectations are positive for holiday sales. Factory orders and production weakened recently, but more industry contacts expect recovery over the next few months than was the case in the last Beige Book. The tourism and hospitality sector is mixed with good domestic business, but there is growing concern that weakness in overseas economies will continue to hold back foreign tourists. Commercial construction remains strong; however, residential building and sales have moderated, and the outlook is for slower growth. Tight labor markets continue to constrain District employers, but significant wage escalations remain limited to a few sectors. Prices remain stable, with a few exceptions.

Consumer Spending: According to District retail contacts, sales during September and early October were up slightly compared with last year. Early October sales were somewhat stronger than September sales. However, most merchants said that recent sales had met or fallen below their expectations, and many retailers report uncomfortably high inventories. Apparel sales remain strong, while shoe sales have been weak in recent months. Looking forward, most merchants expect holiday sales will be up slightly compared with last year.

Construction: Most District builders contacted said single-family home construction and sales slowed somewhat on a year-over-year basis. In both September and early October, construction was flat-to-slightly up in most areas of the District, while new home sales for the same period were flat-to-slightly down compared with a year ago. Realtors report that listing inventories are generally balanced, while builders report that new home inventories are adequate. However, in

select markets, the dearth of available new home lots is said to be a constraining factor. Looking forward, real estate agents' outlooks are mixed, and builders expect slower activity, but at continued high levels. For the year, most contacts anticipate that they will exceed 1997's levels in terms of both home sales and construction. Commercial construction within the District remains strong, although there is some concern that several of the major markets are at their peak in this development cycle. After moderating recently, District multifamily permits have rebounded somewhat.

Manufacturing: Production and new orders at many regional manufacturers weakened since the last Beige Book. The outlook remained hopeful, however, with more contacts expecting moderate increases in production and new orders over the next few months than the last Beige Book. An Alabama steelmaker has announced recent layoffs and rising inventories, blaming this on increasing imports. Tennessee executives characterize expectations for future furniture and textile businesses as poor. District paper producers continue to operate below capacity, and the near-term outlook calls for little improvement. Low oil prices are causing energy extraction companies in Louisiana to cut staffs. Although the Asian crisis has hurt some regional manufacturers of high-tech equipment, strength in European markets is helping others in the sector. Nevertheless, new orders for exports slipped again for most contacts. More positively, a shipyard in New Orleans is diversifying from mostly military contracts by contracting to build a giant crude oil carrier for a major oil company. A producer of household textiles, such as sheets and towels, has announced expansion plans, although labor intensive apparel companies in the region continue to report declining new orders and downsizing. New orders are increasing for some firms in the region's aerospace industry.

Tourism and Business Travel: The tourism and hospitality sector was shaken up by Hurricane Georges but the effect was short lived. Booked conferences were canceled in New Orleans. Casinos on Mississippi's Gulf Coast were temporarily closed but suffered little damage. Although the hurricane missed Miami, tourism is reportedly down from last year. Domestic tourist traffic to the city has been stable, but a significant drop was recorded for international visitors because of weakness in the Latin American economies. Tampa and Miami hoteliers are concerned that the downturn in overseas tourists may continue through year-end. Hoteliers in central Florida, however, are encouraged by strong bookings. Theme parks there are expected to be packed over the Christmas holidays. International travel through Atlanta continues to grow at a double-digit pace.

Financial: Bankers throughout the Sixth District report that overall loan demand has been mixed among loan types. Consumer and automobile loan volume remain healthy, and mortgage demand continues to be strong as consumers consolidate and refinance debt. There have been some reports of slowing in commercial lending, as speculative commercial real estate financing has become more selective. Consumer loan quality has held steady.

Wages and Prices: Contacts continue to report problems with tight labor markets. Some Florida firms are having trouble finding mid-level managers to fill positions that were downsized a few years ago. Although continued low unemployment rates are driving up wages in parts of the region, most firms are absorbing costs in order to remain competitive in the marketplace. Business expansions and relocations are down in parts of the District because of problems with labor availability. Prices remain stable, with a few exceptions. Paper and steel prices remain weak. Competition is expected to hold back most price increases into the foreseeable future.

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SEVENTH DISTRICT--CHICAGO

Summary. The Seventh District economy continued to expand, although some key industry segments softened somewhat. Consumer spending became more mixed than in our previous report and merchants were more cautious about the upcoming holiday season. Housing activity remained exceptionally robust in the region while business construction appeared to slow moderately. Manufacturing activity continued at high levels, but some key industry segments--notably steel and agricultural equipment--were clearly adversely affected by events abroad. Lenders reportedly tightened standards on select loans, commercial real estate particularly, but credit availability was a non-issue for most contacts. Labor markets remained very tight in virtually all locales, despite a decrease in manufacturing employment. District farmers continued to be affected by low grain and hog prices.

Consumer spending. Reports from retailers became increasingly mixed over the last six-to-eight weeks, with overall sales results generally coming in at or below merchants' expectations. Sales at discounters and value-based retailers appeared to be stronger than at middle-market national chains. Fall apparel sales were slower than anticipated in September, partly due to warm weather, but picked up in October as temperatures dropped. One large national retailer reported that sales of some big-ticket items (such as furniture, appliances, and home electronics) were slow while other merchants reported strong sales of the same items. Inventories were reported to be in good shape, although there were reports of greater-than-normal use of promotions, such as one-day sales, for this time of year. One contact indicated that the normal pre-Christmas order backlogs and shipping delays had yet to materialize. A large District auto group reported that light vehicle sales at their dealerships were slow in September, partly as a result of stock market volatility, but had picked up significantly in October. This contact also noted that October's sales strength was broad-based across makes and models.

Housing/construction. Overall construction activity remained very brisk in September and October with the residential side continuing to benefit from very low mortgage interest rates. District homebuilders indicated that sales of new homes were very strong in September, and a national survey of builders suggested that October's normal seasonal slowdown in the Midwest did not materialize. Despite strong sales, most builders noted that traffic through models had slowed recently. Existing home sales in September continued to surpass most realtors' expectations and showed few, if any, signs of slowing in October. Stock market volatility reportedly led to some lost sales of higher-priced homes, both new and existing. While commercial building remained strong, some projects were being scaled back as a result of more conservative lending practices on the part of investors. Speculative office space in some

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suburban areas was reported to be slightly overbuilt and contacts suggested that it may take some lessors longer than anticipated to reach their expected absorption. One contact, noting that “builders will build until they run out of money,” suggested that any tightening of standards would simply bring construction activity back to a more sustainable level.

Manufacturing. Manufacturing activity was mixed in some key industries, but the sector generally remained strong. Effects of the economic turmoil in East Asia continued to adversely impact the District’s producers of steel and agricultural equipment. Steel imports surged in the summer and early fall, leaving regional producers with bloated inventories, softer orders, and little pricing leverage. Industry contacts noted that domestic steel producers had filed trade cases with the federal government, but wouldn’t expect any relief until the spring. Complicating matters for steel producers was softening domestic demand and increased industry capacity. Depressed food commodity prices, due in large part to dwindling demand from East Asia, continued to dampen demand for agricultural equipment, leading some producers to curtail production plans for the fourth quarter. The recently passed farm bill should help lessen the adverse impact on these producers. On the other hand, automakers were anticipating strong light vehicle sales in October, despite some pullback in marketing costs (incentives). Inventories were reported to be good to slightly lean, and production picked up modestly. Automakers were optimistic that they will be able to pull back further on the use of incentives in the fourth quarter. Demand for heavy trucks remained very strong as lean inventories and high backlogs kept producers running near capacity, although one contact noted a slight increase in canceled orders. Strength in the housing and construction industries continued to boost manufacturers’ sales of heavy construction equipment, wallboard, and small appliances.

Banking/finance. Lending activity remained strong, but was uneven on the business side. Overall business lending remained brisk, although demand softened in some segments according to contacts. Some businesses, particularly large companies, were scaling back expansion plans as well as merger and acquisition activity. On the other hand, loan demand from small businesses was reported to be flat, but very strong. Commercial real estate lending slowed somewhat as some investors waited for stability to return to the financial markets. Several lenders indicated that there was some tightening of terms and standards for commercial real estate loans. These contacts also suggested that this was generally done by institutions that earlier had compromised standards slightly as a result of intense competition. The tightening, according to these contacts, simply brought the market back to more prudent practices. On the consumer side, lenders reported that activity remained very high, due in large part to low interest rates. Mortgage interest rates continued to trend downward over the reporting period and this has helped maintain strength in new originations as well as refinancing activity. More than one

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lender suggested record refinancing activity, with one referring to the recent surge as the equivalent of the "1,000 year flood." There appeared to be little change in lenders' attitudes toward consumer loans. Most retailers, auto dealers, and realtors reported no discernible tightening of lending standards, although a regional homebuilder noted that at least one lender was increasing scrutiny of "B and C class" borrowers. District banks also noted an increase in deposits, with some attributing the pickup to investors' flight from volatile stock markets.

Labor markets. The District's labor markets remained very tight and labor shortages persisted, despite a recent increase in the unemployment rate. September's average unemployment rate for District states crept up to 3.7 percent, from August's 3.5 percent, still well below the national average. Total employment growth remained positive and initial unemployment claims through mid-October continued at the very low levels experienced in recent years. Manufacturing employment, on the other hand, has been trending downward since April after nearly a year of expansion that mirrored overall job growth. A few of the region's major manufacturers, most notably producers of agricultural equipment, announced layoffs in response to softening demand for their products. Construction employment also was trending downward, although skilled construction professionals were still cited as being in very short supply in most areas. There is little evidence to suggest that the turmoil in the stock market recently has had an impact on financial services employment in the region. Jobs in financial services continued to rise at roughly twice the rate of overall employment (year-over-year) in the Midwest's financial capital, Chicago. There were no new reports of intensifying wage pressures.

Agriculture. District farmers continued to be affected by low grain prices as the fall harvest proceeded. The corn harvest was halfway finished by mid-October, well ahead of the normal pace, while the soybean harvest was a closer-to-normal 75 percent complete. Farmers selling grain out of the field were aided by a minor price rally during the first half of October. While corn and soybean prices are likely past the harvest-time lows, they remain more than 20 percent below levels of a year ago. Agricultural creditors indicated that, after a few good years, most farmers will be able to withstand this year's low prices, but some could falter if soft prices continued well into 1999. A USDA survey indicated District hog numbers were up 5 percent from last year as of early September, well above the average increase for the U.S. However, low prices (in part the by-product of large production gains) have prompted cuts in the District breeding herd and farrowing intentions for this fall relative to last year. Dairy farmers continued to benefit from high milk prices and low feed costs.

EIGHTH DISTRICT - ST. LOUIS

Summary

Despite some slowing in the rate of growth, the District economy is still operating at a high level. District firms are experiencing some declines in their levels of international sales, but domestic sales have held steady. Tight labor markets remain the norm throughout the District. Some firms have had profit margins narrow, though, and cite fierce competition and rising costs as the cause. Housing sales and construction remain strong, with many areas expecting a record year. Commercial and industrial lending is still increasing at large District banks. With the fall harvest in full swing, it appears that bumper crops will be the norm in northern parts of the District. Unusually dry conditions during a good portion of the growing season in southern parts of the District, however, have adversely affected crop yields.

Manufacturing and Other Business Activity

Most District firms continue to operate at high levels of production. For the most part, credit has not tightened, domestic sales and orders have remained stable, and qualified workers are still scarce. Firms have seen international orders slacken somewhat, particularly from some Asian and South American countries. For example, a firm that exports machinery to Brazil has seen this market dry up over the past six months. Contacts have also recently noticed a moderate retreat in consumer confidence, leading them to be slightly less optimistic about near-term economic conditions.

Several automotive parts plants have been reporting record levels of production as they recoup from GM's strike earlier this summer. As a result, permanent employment has been boosted at these plants. The District's package delivery industry has been strengthened with the opening of

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a high-tech center in Kentucky. A maker of private jets has had such brisk sales lately that it is expanding its District plant, adding almost 300 new employees.

Several District firms producing electrical equipment and food products have seen year-over-year sales increase recently, but profits have been down. They attribute the decline in profits to stronger domestic competition restraining prices and somewhat higher costs. One contact noted that his firm has engaged in “aggressive pricing to maintain market share.” The District furniture industry has seen some slowing lately—sales are down, and labor and materials costs are up—leading to a less-than-optimistic outlook. And General Electric has announced it will outsource its dryer production and close its Louisville line, eliminating about 400 jobs. This move was not a surprise, though.

Most contacts around the District continue to talk about the tight labor markets in their regions, and how this situation is affecting their ability to meet demand. Small businesses, in particular, have been vocal about the problem, saying they generally cannot compete with larger firms in their compensation packages. Several contacts have noted that the Census Bureau, gearing up for the decennial census, is drawing more and more workers from the labor force. Some reports have shown a growing dependence on immigrant labor at nonfarm establishments. In one instance, the immigrant share of a firm’s workforce jumped almost 20 percentage points in about six months. Meanwhile, home builders and general contractors continue to experience severe shortages of skilled tradespeople. These shortages are straining production timetables and raising costs.

Real Estate and Construction

Although monthly residential building permits in August were down in many of the District’s metropolitan areas, residential real estate markets remain strong throughout the District, with both

sales and prices on the rise. Many regions continue to expect this to be a record year. Recent declines in the stock market do not appear to have slowed this trend. Commercial and other nonresidential construction has been much spottier around the District. Much less speculative building is occurring, and commercial real estate agents are reporting a pickup in uncertainty in these markets.

Banking and Finance

Total loans on the books of a sample of large District banks rose just 0.1 percent between early August and early October, after increasing 1.2 percent during the same period one year ago. The decline in growth was entirely due to a drop in real estate loans outstanding, which fell 0.9 percent over the period. Consumer loans rose just 0.2 percent. Commercial and industrial lending, on the other hand, remains robust, increasing 2.1 percent over the past two months. These numbers are consistent with statements by District loan officers and loan customers that business credit is still readily available.

Agriculture and Natural Resources

The fall harvest is largely on schedule, although recent rains have slowed the pace of the harvest in parts of Missouri, Illinois and Indiana. On average, the corn and soybean crops look exceptional in the northern parts of the District, with record or near-record crops expected. In parts of Kentucky and the southern reaches of the District, in contrast, unusually dry conditions during much of the growing season have limited the overall size of crops. Early reports from Delta cotton farmers, for example, suggest yields are running modestly below what many farmers had expected. The lack of rainfall in parts of Arkansas and Kentucky has reportedly caused pasture conditions to deteriorate to the point where many farmers are feeding their livestock from winter hay stocks. Because of last year's bumper hay crop, however, hay supplies seem adequate at this time.

NINTH DISTRICT--MINNEAPOLIS

Despite uncertainty and increasing caution, the level of output in the Ninth District economy continues strong. Construction seems indefatigable and is a source of strength for the broader economy. Consumers continue to buy freely and tourist revenues are the strongest in some time. Manufacturing, which is generally strong, shows increasing variation among firms and some signs of slowing growth. Natural resource sector production continues largely unchanged except for iron mining, which faces cuts due to increased steel imports. Banking remains profitable overall. Labor markets remain tight in most areas. Agriculture, pressed by low prices for crops and livestock, remains the most financially strained sector.

Business sentiment

In September, a regional business conditions index compiled at Creighton University in Omaha using a survey of purchasing managers continued the decline begun earlier in the year. The survey also showed declines in export sales for Minnesota and both Dakotas. Businesspeople contacted for this report generally showed less unease than in early September, but continued to express some concerns about slowing.

Banking

Ninth District banking conditions vary considerably by locality. Banks in areas where commercial and residential real estate markets are active report strong loan demand, increased profitability and solid asset quality. Rural, agriculturally dependent bankers tell a different story. "We are running out of rope up here," remarked a banker in northwestern Minnesota, "Some of our best farmers are quitting." Agricultural banks are reportedly attempting to diversify their portfolios by branching into urban markets.

Construction

"Construction booming in Minnesota, Dakotas," according to a Fargo, N.D., newspaper. Total construction spending in that city is expected to hit a record. The sector is strong in residential, commercial and heavy construction categories in most states. Shortages of workers and subcontractors are common in Minnesota and eastern North Dakota and South Dakota cities. As in recent reports, residential construction is strong in most urban areas. Office building in Minneapolis is at the highest level in 11 years.

Manufacturing

Most manufacturing firms remain busy, but only slight growth is seen overall. Export sales are reportedly down for many firms. Firms making semiconductor-related products also face slack demand. Printing continues strong, and demand for construction machinery is booming. Auto component firms idled by strikes in early fall have resumed full production. Medical device manufacturers continue to grow. General machining and metal finishing shops report mixed conditions, with some continuing a full output but others slowing a bit.

Agriculture

"We are on the verge of some potentially serious problems with poor prices being the primary cause," says a Minnesota banker. Crops were excellent in virtually the entire district, but prices for all grains and oilseeds as well as cattle and hogs are at low levels. Income and investment in the farm sector are clearly the lowest of any in the district. Agricultural trade issues with Canada are a hot topic and actions to restrict imports from that country have been undertaken by farm groups and state governments. Dairy farmers, who enjoy near-record milk prices, very low feed costs and ample hay supplies, are a stark exception to the generally bleak pattern in agriculture.

Energy and mining

The natural resource sector continues slack with little change from earlier in the year. Energy output is stable, with little new leasing or drilling. Nonferrous mines have largely stable output despite low output prices. A Minnesota iron mine shut down one of five processing lines and others are contemplating similar cuts if demand continues to fall. Weakness in demand for ore is attributed to increased imports of steel from several countries. This slackness is reportedly due to strong import competition in finished steel and not any weakness in demand itself. Most paper producers face low prices and some are running below capacity.

Consumer spending and tourism

"We have not seen any cut back yet," says one Minnesota mall manager. This is generally true across the district as retailers continue to report good sales in most urban areas. A South Dakota source reported that 20 new stores, some seasonal, were opening in the state's largest mall. Sales of apparel, recreational equipment, electronics and appliances are all reported as

good. In nonurban areas, structural changes in retailing continue to hurt main street businesses as they have for some time.

"Sales have generally been pretty good," says an eastern Montana auto dealer. "Sales are OK in the bigger towns," reports a South Dakota dealers' association representative noting the negative effects of low farm prices on sales in rural areas. Overall, district auto sales appear unchanged, good but not growing appreciably.

"Tourist season a huge success," headlined a Michigan newspaper's description of activity in the Upper Peninsula. Montana officials described that state's season as one of the three best ever. For the first time in four years, tourism and recreation businesses across the whole district had a very strong year. Expectations for fall hunting business in South Dakota and Montana are also strong.

Employment, wages and prices

"At record 1.2 %, businesses strain to find workers," headlined a Sioux Falls, S.D., news report on the effects of low unemployment rates. "It's the worst year I've seen in 30 years in the business," says the vice president of a Minnesota home builder, in describing how labor shortages are holding back output for his firm. "Labor shortages continue to be the number one problem for many businesses," reported one member of a Minneapolis Fed advisory council. Labor markets continue tight in most towns and cities with populations above 10,000. Firms continue to offer bonuses and extended benefits packages to lure workers.

But some signs of slowing are evident. A Minnesota iron-mining firm reduced overtime hours as it cut production. And in western Wisconsin, unemployment rates edged up over the summer, though they remain below national levels and those experienced a year ago in the area. As in the past several quarters, there are anecdotal reports of substantial salary increases for certain occupations, but firmwide pay increases continue in the 2 percent to 4 percent range.

Price increases are virtually nonexistent at the producer level and small for consumers. One manufacturer said that cheaper steel is helping to offset somewhat higher wages. Motor fuels continue to trend slightly downward.

TENTH DISTRICT - KANSAS CITY

Overview. The district economy continued to grow moderately last month, but signs of easing appear to be mounting. Retail sales and construction activity remained solid, growing at a slower pace than in the recent past. Manufacturing activity slowed slightly last month with fewer plants operating at high levels of capacity. The energy sector improved marginally for the second straight month, although gains are expected to be short-lived. In the farm economy, corn and soybean yields have been coming in below expectations, but record plantings should still lead to a large harvest. Labor markets remained very tight in most of the district, with continued evidence of moderate wage pressures. Prices edged up at the retail level and for some construction materials, while prices for most manufacturing materials continued to decline.

Retail Sales. Retailers reported moderately strong sales last month, with sales growing slower than in the recent past. Inventories have expanded considerably in response to expected stronger retail activity as the holiday season approaches. Most managers appear to be content with current stock levels, and no major changes are expected in the near future. Automobile sales have fallen off moderately over the last few months, with dealers attributing the slowdown more to supply deficiencies than to a lack of demand. In particular, shortages of GM trucks as a result of this summer's strike have led to shortages of all makes of trucks. Most dealers have been expanding inventories and plan to increase their stocks further over the next three months.

Manufacturing. Tenth District manufacturing activity slowed slightly last month, with fewer plants operating at high levels of capacity. Manufacturing materials were generally available, with lead time practically unchanged. Managers expressed mixed opinions about current inventory levels, but nearly all manufacturers have trimmed stocks over the last month and most plan to continue cutting back.

Housing. Construction activity eased slightly last month, as housing starts grew at a

marginally slower pace than in the recent past. Builders expect a seasonal slowdown in activity in coming months and appear less optimistic than in our previous survey. Sales of new homes were virtually unchanged last month, with inventories of unsold homes up slightly from the low to very low levels registered in our last survey. Lenders reported that mortgage demand increased last month and remained much higher than a year ago as a result of strong refinancing activity. Although a seasonal slowdown is likely over the next three months, lenders expect modest to strong activity to persist as interest rates continue to come down.

Banking. Loans and deposits both edged up slightly last month, leaving loan-deposit ratios unchanged. Bankers reported demand for residential home mortgages and home equity loans was up sharply, largely attributable to home refinancings. Commercial and industrial loans for middle- to large-market firms declined slightly, while all other loan categories remained little changed. Increases in money market deposit accounts and demand deposits contributed to the overall increase in deposits.

All respondent banks but one decreased their prime lending rate, and all respondents planned to reduce their prime lending rate in the near term. Most banks held their consumer lending rates constant; however, most also expected to reduce consumer lending rates in the near term. A majority of banks left lending standards unchanged. A few banks reported a tightening of lending standards for all loan categories. Among those banks that tightened lending standards, the primary reason cited was a less favorable economic outlook. Respondent banks indicated their willingness to make loans was unchanged for all loan categories.

Energy. District energy activity improved marginally again in September as oil prices rose steadily during the month. However, activity is expected to decline as prices started to fall in early October. The price of West Texas Intermediate Crude was up 9 percent in September, reaching its highest level since May, while natural gas prices were unchanged from August. Both prices remained well below year ago levels. The rig count was up 2 percent last month, but was 19 percent below the

level posted last year.

Agriculture. With the district corn and soybean harvest well underway, yields for both crops have been coming in below expectations. Nevertheless, record plantings should still lead to a large harvest. Winter wheat planting has been delayed by rains, and in many areas only half of the intended acreage has been planted. Growing conditions have improved recently, however, and most producers expect to have adequate wheat pasture this winter. Wheat pasture is an important source of forage for many district ranchers.

District bankers reported that their overall farm portfolios have deteriorated from a year ago, and concern is rising. However, most bankers do not expect significant repayment problems or foreclosures this fall, as many producers are expected to carry over operating debt into next year. Farmland values and cash rents in the district are weakening due to the low commodity prices. Rural mainstreet businesses in most areas of the district are feeling the effects of the downturn in the general farm economy; farm equipment sales in the district are very slow.

Wages and Prices. Labor markets remained very tight in most of the district last month, with continued evidence of moderate wage pressures. Employers complain that information technology workers remain scarce throughout the district. In addition, retailers continue to experience a lack of entry-level and sales workers, and manufacturers are still facing difficulties finding skilled laborers such as welders and machinists. Builders report that nearly all kinds of construction workers are in short supply, including carpenters, framers, and electricians, yet wage pressures in this sector do not appear to be any greater than in previous surveys. Retail prices edged up last month but are expected to remain stable in the near future. Prices for most manufacturing materials continued to decline and are likely to drop further. Prices of some construction materials, such as insulation and gypsum, were up slightly, while the cost of wood edged down last month. Builders expect only marginal increases in prices over the next three months.

ELEVENTH DISTRICT--DALLAS

Eleventh District economic growth continued to slow in September and October. Manufacturing and energy industry activity declined, while agricultural conditions remained very difficult. Retail sales growth was softer, but still "good." Construction activity also was slightly slower, but at very high levels. Contacts in the service sector continued to report good sales growth. Bankers said there had been a slight tightening of credit standards, and several industries reported difficulty obtaining credit. There was a marked loosening of the labor market for some industries, but labor market conditions remained tight for others.

Prices. Prices continued to decline for many products, and discussion of price increases was virtually nonexistent. Retailers said that selling prices were lower, and stores were making mark-downs earlier than last year. Prices have softened for energy-related products, and are particularly soft for rigs, supply boats and drill pipe. Natural gas prices moved under \$2 per thousand cubic feet, and are expected to fall further before winter arrives because storage is now over 90 percent full. Retail gasoline prices hit the lowest level in six and a half years. Heating oil prices have fallen, and inventories are at the highest level since 1986. Prices for petrochemical products continued to fall, and producers say profits are "rock bottom." New capacity continues to come on-line for many petrochemical products, adding to the industry's problems. Selling prices for primary and fabricated metals are flat to down, with prices down 7 percent to 8 percent for some products. Contacts said that the price declines were due in part to an influx of foreign steel and other metals. Prices were lower for scrap metal and alloys. Cement prices are down 5 percent, and inventories are increasing.

Labor markets remained tight for some types of workers, but loosened markedly for others. In the energy industry, the skill shortages of nine months ago are a memory, as widespread layoffs have been announced involving 10-20 percent of the workforce of a number of companies.

Manufacturing. Manufacturing activity continued to decline. Sales were lower for cement, lumber and most wood products. Contacts said competition is stiff because lower priced lumber is being shipped to the Southwest from Canada and the Northwest. Lumber contacts say the oversupply is the worst they've ever seen in the industry, leading banks to call back some loans, thereby necessitating a search for asset-based lenders. Demand for some types of paper products continued to be strong, but sales of corrugated boxes slowed, and production was cut back. Producers of primary and fabricated metals reported a slight fall off in new orders, although a backlog of orders remains from earlier in the year. Metals producers expressed concern that they would be forced to reduce production when their backlog is worked off, probably early next year. Demand was softer for electrical components and telecommunications equipment. Semiconductor firms reported that the industry appears to have hit bottom, with sales flat for most types of chips, and slightly increasing for some types. Contacts reported that demand for personal computers continued to grow, boosted by sales of machines priced below \$1000. Manufacturers of food products reported steady sales. Apparel producers said that there are signs that sales are picking up, after softness for some types of products over the past few weeks. Demand for gasoline was reported to be seasonally strong. Domestic demand for petrochemical products continued to be very strong, but had weakened in recent weeks. Producers say they are unable to export petrochemicals and are competing with cheap imports.

Services. Demand for transportation services, such as rail, air and trucking, continued to be strong. Temporary service firms reported a slight slowing in demand for their services from the manufacturing industry, although a lack of labor continues to limit their ability to fill orders. Telecommunications firms reported an increase in demand for wireless and data services.

Retail Sales. Retailers said sales growth has been slightly softer over the past few weeks. Contacts expect sales to remain "good," although most have become more cautious about the outlook than they were a few weeks ago, citing concerns about "a lot of negative news," and "consumers becoming

more cautious." One retailing contact said it has become tougher to obtain financing for expansion of new or existing facilities. Stores in Houston and along the Mexican border said sales to Mexican Nationals had dropped off considerably. Auto sales were softer for all types of new and used cars, and even trucks.

Financial Services. Respondents were more cautious than in the last report, citing a perception that credit quality may begin to deteriorate, although there were no reports of increased delinquencies or charge off trends. Most contacts tightened credit standards, which reduced loan demand. Deposit demand was also lower because depository institutions reduced interest rates on deposits to follow the federal funds target rate.

Construction and Real Estate. Construction activity remained at very high levels, but slightly less than the breakneck growth seen in previous months. Housing starts continued to grow strongly, with current labor resources unable to meet demand in some markets. Sales growth slowed slightly for more expensive houses, but lower priced home builders reported no change in sales. Builders continued to report long waiting lists for new homes despite concerns that oil industry layoffs and weak consumer confidence would moderate the sales increases brought on by lower interest rates. Real estate contacts said financing of new office projects had been halted. However, the large amount of office space going up is expected to slightly erode occupancy rates (by about a point) next year in some markets.

Energy. Energy activity continued to decline. Oil-directed drilling is near all time low levels, with natural gas-directed drilling, offshore activity and international activity all declining slowly. Hurricanes and tropical storms moved through the Gulf of Mexico, forcing producers to temporarily abandon producing platforms and refineries, although damage was less than expected.

Agriculture. Agricultural conditions remain very difficult. Adverse weather, high costs, low yields and low prices have left many farmers and ranchers in dire financial shape. Contacts estimate that as many as 25 percent of the region's producers will discontinue production over the next year, particularly small to mid-size farms with no off-farm income source.

TWELFTH DISTRICT—SAN FRANCISCO

Summary

Reports from Beige Book contacts indicated a moderate pace of overall economic activity in the recent survey period, with slowing from previous periods. Retailers reported solid sales volumes but slower growth, while District service providers noted continued high demand for their products. Manufacturing activity was flat in recent weeks, constrained by depressed export demand from East Asia and general slowing in the high-tech sector. District agricultural producers reported weak conditions as falling commodity prices and poor yields continued to reduce profitability. Residential and commercial real estate activity generally remained at high levels, although the pace of growth slowed in most areas and financing of commercial projects weakened noticeably. In general, commercial borrowers in the District faced tighter terms as general economic uncertainty made lenders more cautious. Looking forward, respondents expressed considerable concern about future financial and economic developments.

Business Sentiment

District respondents expect weaker growth from the national economy and their respective regional economies in the coming year. About three-quarters of the respondents expect U.S. GDP growth to fall below its long-run average pace, easing labor market pressures and pushing the national unemployment rate above its current level. Most respondents expect inflation to remain stable or increase slightly, although a growing number (about one-fifth) predict that inflation will fall in coming quarters.

An increasing number of respondents expect economic growth in their region to be at or below the national pace over the next year. Respondents have grown pessimistic about the

strength of business investment and consumer spending in their areas, with more than three-quarters predicting that conditions in these markets will deteriorate over the next year.

Pessimism also is apparent in the outlook for housing starts; more than 50 percent of respondents expect housing starts to decrease over the next four quarters. Global financial and economic turmoil continues to depress net export expectations in the District, with more than 90 percent of District respondents anticipating further deterioration in their regions' foreign trade balances.

Retail Trade and Services

District contacts reported solid retail sales in recent weeks, although growth has slowed from earlier in the year. Respondents noted increased cautiousness among consumers, particularly for purchases of big-ticket items such as jewelry, autos, high-end electronics, and other consumer durables. Retailers of apparel and other soft goods also reported slowing sales, and some expressed concerns about unplanned inventory accumulation. Some District contacts noted that consumers are shopping for bargains and beginning to purchase second-level brands rather than premium brands. Overall, District retailers reported adequate to heavy inventory levels and no supply bottlenecks.

Service providers in most District states reported brisk growth. Demand for telecommunications, data communications, and cable television services remained high, outstripping supply in some cases and putting upward pressure on prices. Tourism-related restaurant sales, car rentals, and hotel occupancy rates were solid throughout the District, although growth moderated in areas dependent on Asian visitors. Conditions in the shipping industry remained strong in recent weeks; growth in import volumes continued to offset declines in exports, keeping activity levels high at District ports.

Manufacturing

Reports on District manufacturing activity were mixed. Contacts in California and the Pacific Northwest noted that excess capacity among makers of computer chips and semiconductor equipment continues to squeeze profits in those industries, resulting in layoffs, temporary furloughs, and some plant closures. In contrast, sales of personal and business computers reportedly strengthened in recent weeks, reducing inventory buildup in production and delivery channels. Conditions among manufacturers of other durable and non-durable goods remained stable. 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 many manufacturers, although respondents noted that the labor market has loosened slightly in recent weeks.

Agriculture and Resource-Related Industries

District agricultural conditions weakened over the past six weeks. Producers throughout the District reported that declining East Asian demand and excess supply of many crops continued to drive commodity prices down and reduce profitability for many farmers. In California, late harvests and poor yields added to these difficulties. Harvests of cotton, wine grapes, prunes, and nuts are as much as three weeks late, and prices for these products remain low. In Idaho, the third consecutive year of poor wheat and potato prices has forced some farmers into bankruptcy.

Real Estate and Construction

Real estate construction and sales remained at high levels in most District states. In California, residential construction remained strong, but demand slowed for new and existing

commercial properties. In the Pacific Northwest, real estate markets cooled in recent weeks. Activity in Washington remained at high levels, but demand slowed, particularly for residential properties. In Oregon, sales of residential real estate slowed substantially, and new building activity declined in both commercial and residential markets. Respondents throughout the District reported that rents and sales prices are stabilizing in the hottest real estate markets. Respondents also noted that financing of commercial real estate ventures became significantly more costly in recent weeks.

Financial Institutions

Twelfth District financial conditions tightened during the last survey period. Commercial loan demand at banks increased as many businesses had difficulty obtaining funds through other channels. At the same time banks have become increasingly cautious, resulting in tighter conditions for borrowers. On the consumer side, lower interest rates are creating abundant demand for mortgages and auto loans. However, some contacts noted that general economic uncertainty has begun to slow loan demand and spur deposit growth.