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

# **Current Economic Conditions**

by Federal Reserve District

June 1999

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## SUMMARY\*

District reports indicate that the U.S. economy remains strong, with gains in activity widespread. Retail activity in most districts has shown little sign of slowing, and consumers remain upbeat about the economy. Home furnishings and motor vehicles sold particularly well in April and May. Manufacturing activity continues to improve in most areas from the sluggish conditions of the past year and a half. Production of such items as electronics, machinery, heavy trucks, and construction equipment has been especially strong, although some sectors, such as steel and apparel, continue to face stiff competition from foreign producers. Construction continues to grow at a brisk pace throughout the nation, spurred by strong home sales in most parts of the country. Shortages of labor and materials, however, have resulted in higher building costs in some districts. Lending activity remains strong in most districts despite a slowdown in refinancings due to slightly higher mortgage rates. In the agricultural economy, growing and planting conditions have been mixed. There is little optimism about farm incomes in 1999, as most agricultural commodity prices remain low. Energy activity in most regions has been slow to react to the recent increases in oil prices, although expectations of a solid recovery are high.

Labor markets remain very tight in almost all districts, with increased reports of upward pressure on wages in many parts of the country. There have been some reports that labor supply constraints are impeding employment growth in many sectors. Prices, however, with the exception of several construction materials, remain well behaved.

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\* Prepared at the Federal Reserve Bank of Kansas City and based on information collected before June 7, 1999. This document summarizes comments received from businesses and other contacts outside the Federal Reserve and is not a commentary on the views of Federal Reserve officials.

## **Consumer Spending**

The strong retail activity in most districts earlier in the year showed almost no signs of easing in April and May, as consumers remained upbeat about the economy. The only district reporting weaker activity was Kansas City, where sales have edged down but are still above year-ago levels. Retailers in the Cleveland district report especially strong sales numbers for May, particularly for specialty apparel items. The hottest selling products in most districts have been home furnishings and appliances, in part reflecting continuing strength in home sales and housing construction. Stores in metropolitan areas of the Dallas and Minneapolis districts posted vigorous sales, but rural merchants in these districts continue to suffer as a result of a weak agricultural sector. Airline and cruise bookings in the Atlanta district remain strong even as prices have edged up, and advance summer bookings for south Florida resorts are higher than a year ago. Labor shortages are a major concern for many retailers, especially for entry-level workers and sales associates. In the Cleveland district, virtually all companies operating amusement parks have been severely understaffed, with some having to cut back operations as a result. Stores in several districts increased their inventories in May in anticipation of robust sales throughout the summer.

Automobile sales increased in most districts in April and May due largely to the continued popularity of light trucks and sports-utility vehicles. Inventories of new trucks have been tight in most places, particularly in the St. Louis and Kansas City districts. Auto dealers in the Chicago district have been able to push through modest price increases.

## **Manufacturing**

Manufacturing activity in most districts has continued to improve from the sluggish

conditions experienced in the recent past. Boston, Atlanta, and Dallas, however, report mixed results, and New York notes some slowing in factory activity. Strong new orders, production, and shipments were reported for many manufacturing products, such as heavy trucks, electronic equipment, machinery, and food and biotechnology products. Brisk demand for construction equipment and building materials has continued across the nation, as construction activity remains strong. Similarly, a strong housing market continues to fuel the demand for appliances. San Francisco reports that increased demand from East Asia has helped paper and pulp processors in the Pacific Northwest. Some sectors continue to report strong foreign competition, however. For example, activity at steel mills remains weak and many apparel producers continue to struggle with competition from cheap imports.

Manufacturers in several regions have expressed concern about labor availability and continue to report difficulties in hiring skilled technical workers, especially in the information technology area. As a result of a shortage of qualified workers, not all of the increase in demand for manufactured goods in the St. Louis district has been met. Additionally, labor costs have become a major concern for most contacts in that district. On a positive note, many districts continue to report healthy productivity gains, with Richmond noting that several manufacturers are experiencing record productivity, in part because of increased capital spending.

### **Construction and Real Estate**

Construction activity and real estate markets remain robust in most parts of the country following an exceptional first quarter. Only New York, Atlanta, and Kansas City appear to be experiencing slightly weaker building activity, but in all three districts activity is still well above year-ago levels. Sales of new and existing homes remain very strong in Chicago and St. Louis,

with a shortage of available houses leading to rising prices and quick sales. Construction in the Kansas City district is expected to pick up considerably over the summer months as Kansas and Oklahoma rebuild from tornadoes that destroyed or severely damaged more than 10,000 homes and businesses.

Commercial real estate markets have improved in most districts. Demand for office space in downtown Boston continues to increase. Retail, office, and warehouse leasing commitments in the Richmond district have been stronger as well, especially in Virginia and the Carolinas. In Chicago, the retail segment has been particularly vibrant.

Builders in most districts continue to complain of substantial shortages of labor, especially for framers. Several construction materials, particularly sheetrock, also remain in short supply. The shortages have created rising construction costs, and project schedules in some districts have been affected, but builders in general remain optimistic about the future.

### **Banking and Finance**

Demand for loans has remained strong in most districts, although some weakness in commercial loan demand has been seen in New York and Atlanta. Several districts report strong competition among banks for high-quality commercial customers, with some indication in Chicago that this may be affecting lending standards. In most districts, however, lending standards remain generally unchanged.

Higher mortgage rates appear to have slowed refinancing activity across the country, but real estate loan origination and consumer lending remain strong overall. Chicago, New York, and Philadelphia report some signs of weakness on the consumer side, however. Loan delinquency rates have shown some improvement across districts.

## **Agriculture, Energy, and Natural Resources**

In the agricultural sector, growing and planting conditions have been mixed across districts. Cleveland, Chicago, St. Louis, and Dallas report planting has been generally at or ahead of schedule. Dry conditions have hindered planting and crop development in some areas of the Richmond and Cleveland districts, however, while Minneapolis has seen some problems caused by wet fields.

There is little optimism about farm incomes across districts, as commodity prices remain low. As a result, agricultural credit markets are somewhat stressed, with Minneapolis reporting increases in farm liquidations and bankruptcies and Chicago reporting a general slowing in agricultural loan repayments.

Oil exploration has been slow to react to price increases in most areas, but expectations of a solid recovery are high if the price increase is sustained. Some increases in activity have been seen recently, such as in the Kansas City district, but rig counts remain well below year-ago levels.

## **Labor Markets, Wages, and Prices**

Labor markets were extremely tight last month in almost all districts, with no signs of easing in the foreseeable future. Despite the summer influx of student workers, temporary employment firms in many districts have been unable to fill all their job openings. Employers in Cleveland are hiring temporary workers in hopes they will become permanent employees after a short trial period. Richmond, Chicago, and St. Louis note that severe labor supply constraints are hampering employment growth in many sectors.

Although labor shortages are reported in almost all sectors, some skilled workers have been in especially short supply and many employers have broadened their searches from local to regional and national levels. Information technology workers, in particular, are very difficult to find. As an employment agent in Northern Virginia put it: “Anyone that can operate a personal computer can get a job.” Skilled tradesmen in the construction sector are also extremely scarce, especially in urban areas where the building boom continues. The Minneapolis district reports that builders in Duluth imported 200 trade workers due to the lack of available local workers.

Persistently tight labor markets have resulted in many reports of increased wage pressures, especially for some specific industries and skilled occupations. Chicago, St. Louis, and Richmond report upward wage pressures in almost all sectors, while other districts report more scattered wage increases. For example, retailers in the Boston district report a recent increase in the use of higher wages as a recruiting tool, while a large retail chain in New York notes increased wage pressures primarily for entry-level positions. In Dallas, wages have risen for truckers, secretaries, legal assistants, and workers with technical skills. Similarly, wage changes in San Francisco have been generally limited, but increases were noted for some types of workers. Cleveland and Philadelphia report that wage pressures have generally been held in check, but rising benefits costs have become more common. The Kansas City district is an exception, as wage pressures there appear to have eased somewhat from previous surveys.

Many districts suggest that employers have continued to be creative in finding and recruiting additional labor. Employers in the Atlanta district, for example, appear to be using more bonuses and incentives as part of total labor compensation, and many companies are using more part-time workers and consultants as well as allowing employees to work at home. Some firms in the Boston district are avoiding higher labor costs for new hires by outsourcing and

changing work assignments internally.

Prices remain generally subdued, but many districts report pockets of higher prices for some specific sectors and goods. At the retail level, price increases have been marginal and infrequent. Retailers indicate that stiff competition continues to restrain price increases. Dallas, for example, reports that smaller markdowns have resulted in a slight increase in average selling prices and Kansas City notes that retail prices continue to edge up. Chicago suggests there have been a few signs that consumer resistance to price increases has softened somewhat. In contrast, retailers in the New York district report that selling prices and merchandise costs have been flat to slightly down. Prices for manufacturing goods and materials have held steady, with modest increases for a few items, such as cardboard, packaging materials, metals, and ethylene-based petrochemicals. The big exception has been building materials, especially sheetrock, which continues to experience substantial price increases. Housing prices and commercial rental rates have also increased in several districts.

## FIRST DISTRICT - BOSTON

The First District economy continues to expand. Retailers report strong sales growth while manufacturers' results are mixed, with business up compared with a year earlier at about half the contacts and down at half. Business continues to grow at temporary employment firms and insurance companies and in most of the region's commercial real estate markets. Retailers report that vendor prices and prices to consumers are mostly steady; manufacturers also indicate their input costs and selling prices are mostly flat or down, but a few say they are able to raise prices to customers slightly. According to respondents, most workers' pay increases are in the 3 to 5 percent range.

Retail

All retail contacts report strong growth during the March through May period relative to the same period last year, with sales expanding at a 5 to 10 percent pace. Only one sector, office and architectural supplies, said sales growth was below expectations, with some signs of a recent slowdown.

Employment is said to be holding steady, with very tight labor markets impinging on merchants' ability to find and hire new help. Retailers also report a recent increase in the use of higher wages as a recruiting device. Nonetheless, overall wage growth is said to be in the same 3 to 5 percent range that has existed for most of the last two years.

Most respondents report that retail prices are holding steady, primarily because of competitive pressures. Supplier prices are also said to be holding steady. One exception is construction supply retailers, who say that materials prices are rising dramatically, as supply is short relative to construction demand. Most retail contacts say gross margins are holding steady.

Contacts report that little or no capital expansion is planned for the remainder of this year, and some moderate capital expansions are planned for the year 2000. Looking forward, respondents express continued optimism about the economic outlook, although they expect the rate of economic growth to slow during the second half of 1999.

### Manufacturing and Related Services

First District manufacturing contacts are about equally split as to whether recent business is up or down from a year ago. Demand is growing most strongly for biotech instruments, publishing, office equipment, and goods and services related to construction. Equipment suppliers say the semiconductor industry is rebounding from its slump. Demand for industrial machinery reportedly remains weak. A maker of apparel textiles reports negative trends, largely because of competition from imports.

Manufacturers report that input costs are mostly flat or down. The sharpest declines are for integrated circuits and computer components. By exception, prices for corrugated cardboard and plastic packaging are said to be starting to rise. Some contacts anticipate that paper prices may increase soon, although none are paying higher prices yet. One-quarter of the contacts report being able to raise prices slightly. The remainder report that selling prices are flat or down, with some equipment makers reporting sizable decreases as a result of technological improvements or customer pressures.

The majority of companies report that they are hiring for sales, engineering, information technology, and/or other technical positions. Almost half are cutting jobs or hours for factory and lower-level service workers. Most companies report average pay increases in the range of 3 to 5 percent. Despite tight labor markets, only a few respondents indicate that hiring expenses are increasing faster than average pay; a couple of these firms report changing work assignments internally or contracting work out in order to avoid what they view as excessive costs for new hires.

About one-half of manufacturing contacts plan to increase capital spending this year. The most commonly cited reasons are Y2K, computer upgrades, and modernization of facilities. Most firms do not plan to build up inventories later this year in anticipation of Y2K, but a few indicate they will accelerate orders from critical suppliers.

Most manufacturers are upbeat about their business over the coming year. To the extent they have concerns, these tend to relate to their own company's sales challenges rather than to conditions in the economy at large.

### Temporary Employment Firms

First District temporary employment firms continue to expand, although the pace of growth has slowed largely because of supply constraints. Demand is strong, with firms reporting substantial increases in demand for information technology (IT) workers, especially for software and Internet development. Contacts say they cannot find enough people to fill all the IT jobs. The summer influx of student workers may temporarily alleviate some of the supply shortage for general office work, but this will not help firms searching for highly skilled, experienced workers or workers for longer term projects. Wages are increasing 10 percent annually for IT workers and 5 percent outside that sector; temp firms are passing these increases on to their customers, so profit margins remain steady.

### Commercial Real Estate

The commercial real estate market in New England is doing well and most contacts are optimistic. While some Massachusetts respondents say that the market is becoming less active, others see no signs of slowdown. Demand for prime office space downtown is very strong, and supply will not increase until new construction projects are completed during the next one to two years. Office rental rates continue increasing in downtown Boston but have been steady in the suburbs.

The rest of New England is mixed. Providence is doing very well, with strong demand and rising rental rates for industrial and suburban office space. The market in Hartford is unchanged, although several new projects are planned. Southern Maine and southern New Hampshire are experiencing high levels of activity, but report no change in vacancy or rental rates.

### Nonbank Financial Services – Insurance

All but one respondent at insurance companies reports an increase in sales during the first quarter of 1999. The increases were mostly traditional individual life insurance products. Despite sales growth, most respondents indicate that they have either reduced employment since the beginning of the year or expect to do so in the second part of the year. One respondent has a hiring freeze in effect and two are implementing early retirement programs later this year.

## SECOND DISTRICT--NEW YORK

The District's economy continues to expand, though at a somewhat slower pace than in the last report. While there are scattered reports of upward price pressures, they appear to remain relatively subdued. Most retailers report that sales were above plan in May, despite unseasonably cool weather which held down sales of summer merchandise. Residential real estate markets remain strong, though activity appears to have leveled off in the second quarter, largely due to supply constraints.

Regional purchasing managers report a slowdown in manufacturing activity in May, along with some upturn in input prices. The breakup of Conrail and its recent merger into CSX and Norfolk Southern appears to have caused only minor operational glitches thus far. Local banks report a dip in demand for residential mortgages and consumer loans, and continued improvement in delinquency rates.

**Consumer Spending**

Retailers report that sales were on or above plan in May, and would have been stronger still, except that unseasonably cool weather held down sales of summer merchandise. Overall, same-store sales for May were up by roughly 4 percent on average, though individual gains ranged from 2 to 8 percent. However, these figures understate underlying growth since they are based on a 4-week month that included Memorial Day in 1998 but not in 1999. Virtually all contacts report very strong follow-through in sales in late May and early June. Most retailers surveyed report sluggish sales of lawn and garden, air conditioners, swimwear, and other summer merchandise, but generally brisk sales of apparel and home goods. Most contacts also cited Star Wars merchandise as a contributor to strong sales.

Retail inventories are generally said to be at satisfactory levels, though one contact describes them as "a bit heavier than desired." Most retailers report that selling prices and merchandise costs were flat to slightly lower, though one major chain notes an increase in costs for autumn private-label apparel imports. Another large chain notes increasing wage pressures for entry-level workers.

### **Construction & Real Estate**

Housing demand in the District remains strong early in the second quarter, though the general level of activity appears to have lost some momentum, largely due to supply constraints as well as a mild winter (which boosted first-quarter activity). In April, single-family permits in New York and New Jersey slipped roughly 6 percent below first-quarter levels (seasonally-adjusted), but were still up 10 percent from a year earlier. Multi-family permits retreated sharply, following spectacular gains in the first quarter and especially March; year-to-date, they are still up more than 65 percent from 1998 levels. Homebuilders in New Jersey report that new home sales remain strong in the second quarter, despite a drop-off in buyer traffic from torrid first-quarter levels. They also note that prices for homes sold in early 1999 rose an average of 11-12 percent from a year earlier, based on comparable sales. Most of this increase reflects sharply rising land prices due to a shortage of available land. There are increasing reports of labor shortages in construction—particularly for framers.

Sales of existing single-family homes in New York State slowed somewhat in April. However, realtors contend that demand continues to be exceptionally strong (as reflected in scattered bidding wars), and that activity is being held down by a shortage of available homes for sale—particularly in the counties adjacent to New York City, where the inventory is said to be at “historic lows.” Compared to a year ago, the number of homes on the market is down 35 percent in Nassau County and 25 percent in Westchester. Even in the Buffalo area, where the economy has been sluggish, there are 10 percent fewer homes on the market than a year ago, while home sales are approaching record levels.

New York City’s office market has shown further signs of stabilizing in April. Office vacancy rates in Manhattan were little changed: Midtown’s availability rate edged down from 8.1 percent to 7.7 percent, while Downtown’s edged up from 11.8 to 11.9 percent. Manhattan office rents also appear to have leveled off thus far in 1999—after rising by more than 20 percent during 1998, rents have barely

changed since the beginning of this year, though they were up 14 percent from a year earlier in April.

### **Other Business Activity**

The breakup of Conrail and its recent (June 2) merger into CSX and Norfolk Southern appears to have caused only minor operational glitches thus far, according to contacts in upstate New York. Substantial resources have been devoted to integrating computer systems in order to avoid the problems encountered in the 1998 merger between Union Pacific and Southern Pacific. One operator of a small railroad in western New York says the merger is already starting to bring down rail-shipping costs.

The trucking industry is unlikely to be affected much by increased competition from this merger, according to an industry expert. However, the recent jump in fuel prices may have a sizable effect on industry profits, as truckers will probably not be able to pass along the full cost increase to shippers.

Regional purchasing managers' surveys indicate some slowing in manufacturing activity in May, along with a rise in commodity price pressures. Buffalo purchasers report that manufacturing activity slowed in May—production activity grew at a slower pace than in March and April, new orders remained flat, and employment edged down. They also note a sharp upturn in commodity prices, which had been declining through most of 1998 and early 1999. New York City area purchasing managers also report that manufacturing activity retreated in May, following strong growth in March and April, but that growth in non-manufacturing sectors remained solid. Prices paid for commodities were little changed in May, while costs of contracted services rose at a somewhat slower pace than in April.

Hotel occupancy rates in New York City have ebbed from their peaks reached in early 1998 but remain exceptionally high—April's rate was 81 percent, down from 84 percent a year earlier. Room rates continue to increase but at a much slower pace than last year; after rising more than 10 percent in 1998, rates have been running about 5 percent ahead of 1998 levels this year. On a seasonally-adjusted basis, room rates have declined modestly from their peaks reached in the final quarter of 1998.

**Financial Developments**

According to a survey of senior loan officers at small and medium sized banks in the District, overall loan demand has dipped in the past two months. Bankers report a downturn in demand for residential mortgages and consumer loans and slower growth in demand for commercial and industrial loans and nonresidential mortgages. Two-thirds of banks reported a decrease in refinancing activity. Very few respondents indicated a change in credit standards in either direction; however, more recent contacts suggest some tightening in standards for residential mortgage and home construction loans.

Changes in interest rates were mixed—residential mortgage rates increased, on balance, while rates on consumer loans declined. Rates for nonresidential mortgages and commercial and industrial loans were generally stable. Average deposit interest rates rose slightly, on balance. Delinquency rates continued to fall for all categories of loans.

## THIRD DISTRICT – PHILADELPHIA

Business activity in the Third District continued to increase in May. Manufacturers in most of the region's major industrial sectors reported further gains in shipments and orders. Retailers posted higher sales in May than in April, and year-over-year increases were generally strong. Auto dealers also had improved sales in May compared to April. Bankers indicated that demand for business loans was on the increase and real estate lending remained at a high level. Consumer lending was rising, on balance, although some banks noted flat or falling personal lending. Real estate markets have been active. Home sales have been increasing, and commercial real estate leasing has been strong.

Looking ahead, most of the Third District businesses contacted for this report have positive outlooks. Manufacturers forecast further increases in orders. Retailers expect sales to remain on an upward trend. Bankers expect overall lending to continue rising, led by an increase in business credit. Builders and property managers anticipate more construction and leasing activity in the second half of the year.

MANUFACTURING

Manufacturers contacted in May reported continuing gains in business, on balance. Around one-third said shipments and orders increased during the month, and less than one-fifth said these measures had fallen at their firms. Increasing activity was noted in all major industrial sectors in the region except among producers of paper products and primary metals. Steel makers reported that intensifying foreign competition was limiting domestic firms' sales and holding prices down. Overall, area manufacturers continued to indicate that prices for both the goods they buy and the products they make remain steady.

The forecast for Third District manufacturing remains positive, on balance. More firms expect increases than decreases in orders and shipments over the next six months. A modest increase in order backlogs is predicted among the firms contacted for this report, but delivery times are expected to decrease a bit. Some increases in employment

and working hours are planned, but roughly two-thirds of area plants will hold workers and hours steady.

### RETAIL

Retail sales in the Third District increased in May from April, according to merchants contacted for this report, and several store executives noted strong year-over-year gains as a result of healthy Memorial Day sales this year. Warm weather in late May and early June was boosting sales of summer apparel and other seasonal merchandise. The combination of strong sales of summer goods and gift items for graduations and Fathers' Day was leading the sales rate higher in June as well. In general, retailers are optimistic that the strength in sales will persist into the summer.

Auto dealers reported an increase in sales in May compared to April. The continuing popularity of light trucks and manufacturers' incentives on sedans were bolstering the sales rate. In general, dealers described inventories as appropriate for the current pace of sales, although some said their supplies of the most popular types of vehicles were lean.

### FINANCE

Third District banks were posting gains in loans in the major credit categories in May, although some banks reported that consumer loan volume was flat or falling. To some extent this reflected a moderating of demand for personal credit, but some banks said they were intentionally reducing some types of consumer lending in order to reallocate resources to more profitable credit areas. Bankers said that loan demand was rising from small and medium businesses in a wide variety of industries that were expanding capacity, and they expect this trend to continue. Real estate loan demand, both residential and commercial, remained strong. Banks indicated that property development activity has been rising and developers have been looking for increased leverage in order to maintain their growth.

### REAL ESTATE AND CONSTRUCTION

Home builders gave generally positive reports for May, indicating continuing high sales rates or increases compared to the prior month. Several builders mentioned that sales of homes in higher price ranges were rising more than lower priced homes. Some builders indicated that they had recently posted price increases of a few percent for

single homes while keeping townhouse prices steady. Although some builders reported difficulties in locating supplies of some materials, primarily wallboard, none of those interviewed in early June said that their construction schedules had been delayed as a result. Sales of existing homes have also been on the increase, and real estate agents said prices have started to appreciate more rapidly than they did last year.

Commercial real estate markets in the District continued to tighten, according to local developers and property managers. Leasing activity has been strong so far this year and rents have been rising. Recent estimates of vacancy rates were around 5 percent in Wilmington, 13 percent in Philadelphia, and in a range of 5 to 12 percent in suburban locations. In most areas, office vacancy rates have decreased about one percentage point since the end of last year. Industrial buildings continued to be in demand in the region, and conversion of older structures to nonindustrial uses has reduced availability and prompted construction of new space. Most of the demand is for flex space and warehouses, although some new manufacturing facilities have been built recently. Contacts in the commercial property industry said sources of private financing have become more active in the region, and they expect construction, leasing, and sales to increase through the rest of the year.

#### PRICES AND WAGES

Businesses in the Third District noted price increases for some of the goods they purchase, and some firms have recently raised prices for their own products. Overall, however, increases have been slight and infrequent. Most manufacturers said markets remain very competitive, especially for products that are imported as well as produced domestically. Retailers also said that they have seen little or no increases in prices of the goods they purchase, and they noted the damping effect of foreign supply on prices as well.

The rate of wage increase in the region does not appear to have accelerated, according to businesses surveyed in recent months. However, reports of rising benefits costs have become more common. Some labor contracts that have been signed at area firms recently included wage increases averaging around 4 percent per year over the life of the contract.

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### FOURTH DISTRICT - CLEVELAND

#### **General Business Conditions**

The Fourth District economy is still quite strong, and worker shortages remain a concern for many companies.

District temporary employment agencies report an increase in demand for temporary workers this quarter compared to a year ago. A typically strong demand for seasonal help has been augmented by a large, sustained rise in the demand for long-term temporary help. A large number of companies are hiring temporary workers with the hope of making the workers permanent after a short trial period. Many agencies have recently increased wages for a variety of positions. The largest wage hikes are reported for administrative assistants.

Many District firms report having difficulty attracting the usual numbers of seasonal workers. Virtually every amusement company is reported to be understaffed, and some are said to be paring down their operations because of this. Although the starting wage for unskilled seasonal workers has not increased significantly, many companies indicate having boosted benefits, and some have instituted end-of-summer bonuses to attract and keep workers.

#### **Construction**

Although reports vary widely by company, most contacts indicate that residential construction has improved this quarter relative to the strong first quarter numbers.

Labor and materials shortages continue to plague homebuilders. Skilled trades workers, for example, appear to be in short supply throughout the District, with the

possible exception of northern Ohio. Still, cost increases, estimated between 2 and 4%, are relatively subdued.

Commercial construction activity for the District is also mixed. One contractor reported year-over-year growth this year of nearly 20%. Another contractor described conditions as slow compared to last year. Overall, commercial construction activity has picked up from the relatively modest levels seen in the first quarter.

Commercial builders report spotty materials shortages and price increases. Many say they are also being more vigilant about recruiting and retaining employees. One respondent cited a shortage of skilled manpower as the single biggest threat to his firm's future prospects.

### **Agriculture**

District farmers report very favorable growing conditions, and most crops are developing faster than usual for the season. In Ohio, the planting of the corn crop is nearly complete—a month earlier than usual. Soybean crops are also well ahead of schedule and favorable reports are also heard for a variety of other crops in the state. In Pennsylvania, where rainfall has been more variable, crops are about one week ahead of schedule.

Similar conditions are indicated in Kentucky, with tobacco, corn, and soybeans developing well ahead of schedule. However, some eastern Kentucky farmers are experiencing problems with crop germination because of drier-than-usual conditions. Some tobacco farmers have had to replant portions of their crop. Early June rains have alleviated some of the problem.

**Industrial Activity**

Manufacturing activity is good overall. Heavy truck production and sales are running above last year's record pace. Most capital goods makers have seen continued, strong sales and production this quarter. Commercial construction equipment manufacturing is especially strong. Even industries which had shown weakness earlier in the year, such as energy-related and semi conductor equipment manufacturing, appear to have improved a bit from earlier in the year.

Modest gains are reported in the steel industry, helped in large part by the continued strength in the automobile and residential construction industries. Steel prices have risen marginally since the beginning of the year. Some business analysts caution that the recent positive developments in the industry may reflect steel customers' hedging against a potential steel workers' strike later this year.

Upward price pressures are reported for industrial commodities, including most energy and metals prices. However, finished goods prices are flat, or mildly lower.

**Consumer Spending**

District retailers report very strong sales numbers for May. Specialty apparel store receipts have been exceptionally high, with several stores reporting double-digit growth compared with this time last year. Similarly, chain-store apparel sales are roughly 7% above last year's numbers. Apparel sales are expected to be strong through the season.

Retailers see labor market conditions as very tight—filling positions for all jobs is difficult, and worker demand has not been adequately satisfied by the inflow of seasonal help. Still, wage pressure is said to be modest.

The pace of District new-car sales was brisk in April and May. April sales were generally characterized as better than average, and the May sales numbers were universally very strong. Dealers report having sufficient stocks to meet the demand. Used vehicle sales were reported to be holding steady relative to the first quarter.

### **Banking and Finance**

Lending activity in the District was mixed for commercial loans. Some banks report “phenomenally good” demand while others have seen a slower lending pace recently. Demand for consumer loans is steady at a high level.

No deterioration in credit quality or changes in credit standards have been reported. Indeed, consumer and commercial loan delinquencies may have actually improved a bit in recent months.

The willingness among financial institutions to lend remains high, and the competition for borrowers is still fierce. The spread between borrowing and lending rates is still thin and may have narrowed further since the last District report.

**FIFTH DISTRICT – RICHMOND**

**Overview:** The Fifth District economy continued to advance at a rapid clip in late April and May. Business services and financial firms reported stronger demand and retailers noted continued strength in automobile and housing-related sales.

Manufacturers continued to increase output and, in some cases, raise productivity. The real estate sector remained upbeat; housing sales were brisk and commercial activity was strong in Virginia and the Carolinas. Lending at banks remained strong although higher interest rates slowed the pace of mortgage refinancings. Labor markets tightened further and wages rose somewhat faster in the retail and services sectors, but prices increased only moderately. In agriculture, dry weather hampered spring planting and crop development in many areas of the District.

**Retail:** Retailers reported increased sales since our last report, but growth has slowed compared to earlier in the year. Automobile and housing-related businesses fared especially well in recent weeks. Retail inventories expanded in May as stores anticipated stronger sales in coming months. Retailers expressed increased concern over their inability to attract workers. A hardware retailer in Columbia, S.C., for example, complained that a "lack of employees was stopping growth" at his firm. Reports indicated that strong wage growth persisted, but the size of the retail workforce was little changed. Price gains remained modest; many contacts said that although wages were rising, competition prevented them from raising their prices.

**Services:** Services revenues expanded at a brisk pace in recent weeks, driven by stronger demand for business and financial services. Real estate firms benefited from the District's strong housing markets while favorable weather increased travel and boosted hotel revenues. After pausing in April, services firms added to their workforces in May. Labor markets remained extremely taut and led to higher wages for workers in business and professional services. Prices, however, rose only modestly since our last report.

**Manufacturing:** District manufacturing activity continued to grow at a moderate rate since our last report. Shipments, new orders, and capacity utilization maintained the pace set earlier this year. However, producers of food, chemicals, and fabricated metal products firms reported a notable increase in their businesses. One chemical manufacturer said that "business growth has been good and continues to hold." Several

manufacturers noted that they were experiencing record productivity, in part because of increased capital spending. A fabricated metals producer said, "Productivity is our salvation at this plant. If it begins to subside, price inflation will follow." In labor markets, wages and employment fell, but the average workweek was little changed. Price pressures remained generally dormant; only scattered increases were noted by District manufacturers.

**Finance:** District loan officers reported that loan demand remained strong although higher interest rates slowed the pace of mortgage refinancing activity in late April and May. A Greenville, S.C., lender described mortgage refinancings as being "choked off" by rising mortgage rates. In contrast, new loan originations were generally steady and mortgage lenders continued upbeat, noting that housing markets remained robust and that mortgage rates stayed relatively attractive. Commercial lending activity was strong, driven by continued solid business expansion and construction activity in the region. Commercial lenders characterized competition between banks for commercial accounts as intense and told us that lending institutions continued to "steal customers" from their competitors.

**Real Estate:** Realtors reported that residential home sales continued at a brisk pace in recent weeks, especially in selected areas of Virginia. Prices were said to be rising sharply in popular neighborhoods in Northern Virginia, Richmond, and Virginia Beach. District realtors said that mid-priced homes were currently the strongest market segment, except in West Virginia where homes priced below \$125,000 were noticeably stronger. One West Virginia builder said, "Anything above that, I wouldn't build speculative for love nor money." Homebuilders throughout the District continued to report shortages of skilled labor and building materials, particularly drywall. One upstate South Carolina builder told us that despite low unemployment rates in the area, construction workers could still be found; however, quality of these workers, in his words, "leaves a lot to be desired."

Commercial real estate activity was stronger in recent weeks, particularly in Virginia and the Carolinas. The pickup in activity was most noticeable in Charlotte, N.C., where, according to one contact, there were "a lot of tenants making big space commitments ... big companies [that were] bullish on the market." The acceleration included new retail, office, and warehouse developments. In South Carolina, stronger

growth was driven by new companies relocating to that area, which pushed rental rates higher. But some realtors were less optimistic regarding continued strength in the sector. In Northern Virginia and North Carolina, realtors were concerned that there may be insufficient demand to absorb the new office space coming to market.

**Tourism:** Tourist activity was somewhat stronger in recent weeks. A contact on the Outer Banks of North Carolina told us that--in contrast to a year ago--local hotels were "almost booked to capacity" during the Memorial Day weekend. Several hoteliers in the area reported that excellent weather during the holiday weekend boosted consumer spending on outdoor sports such as windsurfing, kayaking, golfing, and fishing. In Myrtle Beach, S.C., record-breaking attendance at two motorcycle rallies revved up tourism in May. Most contacts commented that hotel rates had increased recently and would likely continue to move higher as the summer season progressed.

**Temporary Employment:** The demand for temporary workers rose further in recent weeks placing additional strains on the District's already stretched labor markets. Although labor remains plentiful in rural areas hit by textile plant closings or cutbacks in coal operations, qualified workers were becoming extremely scarce in most urban areas of the District. According to one contact in Charlotte, N.C., manufacturing firms, in particular, have been scrambling for workers and paying dearly for them. In addition to skilled manufacturing workers, "anyone that can operate a personal computer can get a job," according to an employment agent in Northern Virginia. Our contacts indicated that wage increases have become widespread across job types and industries in recent weeks.

**Agriculture:** Unseasonably dry weather across most of the District in recent weeks continued to threaten crop development and hamper planting progress in many areas. A shortage of rainfall led some South Carolina cattle producers to supplement their pastures with hay, and in Maryland, reports of herbicide failure due to inadequate moisture were widespread. Some soybean producers in Maryland have halted planting until more moisture becomes available for proper germination of their crops. Despite dry conditions, the peach crop in the Carolinas was reported to be the best in years.

**SIXTH DISTRICT – ATLANTA**

**Summary:** Moderate growth continues in the Southeast. Merchants report that sales have generally met expectations, and the outlook is positive. The tourism and hospitality sector continues to post strong numbers. Residential building and sales have slackened from high levels, and the longer-term outlook has weakened. Commercial construction remains healthy. Bankers note strong loan demand, especially from consumers. Factory production has been mixed across industries, but announcements of new projects have boosted the outlook. Labor markets remain tight as employers search for scarce workers, but reports of accelerating wage pressures are mostly limited to high-tech workers. Prices remain stable with a few exceptions.

**Consumer Spending:** According to reports from District retailers, sales during May ranged from flat to up significantly on a year-over-year basis. Most contacts say that recent sales have met expectations. Most report balanced inventories, although a notable minority notes high inventories. Women's apparel sales have been strong over the last month, while men's and children's apparel sales have been mixed by store. Looking forward, retailers anticipate second quarter sales growth to be flat to slightly up, while third quarter sales are expected to be slightly stronger.

**Tourism and Business Travel:** Reports from the tourism and hospitality sector are mostly positive. One Florida contact notes that weather disasters such as hurricanes and wildfires are the only potential stumbling blocks to record receipts this summer. Airline and cruise bookings reportedly remain strong even as prices inch up. Cabin utilization rates on cruise ships are high, even though capacity is up by double-digits from last year for some cruise lines. Advance summer bookings for south Florida resorts are about the same as last year or slightly

higher. The ongoing expansion of Florida theme parks is expected to attract more visitors to the state, although there are new concerns of overbuilding. Lenders to hotels and to the amusement and gaming industries in the Southeast say that occupancies and tourist traffic will remain at historically high levels, at least for the near term. Mississippi casinos report record revenues, and new projects have been announced.

**Construction:** Reports from District builders on single-family construction and new home sales in April and May show little consensus. Many builders continue to note material and lot shortages, which are slowing construction. Builders anticipate construction levels to be flat to slightly up compared with last year during the second and third quarters. Realtors also report that home sales have been mixed recently. Listing inventories and new home inventories are described as balanced in most parts of the District. Real estate agents' second quarter outlooks varied widely, while third quarter expectations are weaker.

The pace of commercial construction in the District remains similar to our last report. Office, industrial, and retail markets in the region generally remain balanced. Downtown office markets in the region continue to improve, while many suburban markets have experienced slight increases in their vacancy rates. Industrial vacancy rates have also risen in several key markets, but the increases remain subdued. Retail construction remains robust, although several large retailers are exiting some local markets or scaling back on the number of stores.

**Manufacturing:** Manufacturing activity is mixed across industries, but recent announcements brighten the long-term outlook. Contacts in Louisiana are disappointed that layoffs and cutbacks continue in the oil industry despite rising energy prices. A large military contractor has announced layoffs at a Georgia facility. Future operations at an Alabama steel mill are uncertain because of a continued influx of cheap imports, according to industry

spokesmen. However, employment and new orders are increasing for Georgia producers of electrical and electronic equipment and machinery. In addition, two major announcements boost the long-term outlook for the District's factory sector. The recently announced plans by Honda Motor Company to build a \$400 million 1,500-worker facility to produce minivans or SUV's in Alabama has economic developers crowing, as does the announcement that Dell Computer will build a new plant in mid-Tennessee, resulting in thousands of new high-technology jobs.

**Financial:** Despite a slight moderation of activity in some sectors, overall loan demand remains quite strong throughout the District. Consumer loan demand remains very robust, and commercial demand remains healthy overall despite some reports of slowing. Automobile loan demand is holding steady, and mortgage demand and refinancing activity have continued to slow. Although bankruptcy filings have fallen, consumer credit quality and loan standards remain unchanged.

**Wages and Prices:** Contacts report a continuing struggle to locate and retain skilled workers. Employers are reportedly using a wide variety of means to acquire workers while resisting greater-than-average wage increases. Bonuses and incentives are becoming increasingly important factors in compensation. Increased dependence on part-timers and consultants, as well as a greater willingness to allow employees to work at home, are holding down costs for some District firms. However, companies are spending more on training as the skill level of available workers falls. Employers of skilled workers are broadening employee searches to a regional and national level.

Most contacts report a stable price picture, with some exceptions. Health insurance premiums are increasing at double-digit rates in some parts of the District. Prices of building materials, especially sheetrock, are rising. Airfares are increasing.

**SEVENTH DISTRICT—CHICAGO**

**Summary.** The Seventh District economy continued to expand at a modest pace in May and early June as reports of intensifying price pressures became more frequent. Sales of home-related items and light vehicles led strong consumer spending as consumers' resistance to price increases appeared to be softening. Construction activity continued very strong even as shortages of labor and some types of building materials slowed some projects. Manufacturing activity was robust with motor vehicles and construction-related industries running near capacity, while steel and agricultural equipment producers continued to struggle. Despite a sharp dropoff in home refinancings, overall lending activity remained strong. Labor markets were again tighter in the District than the nation as a whole, and reports of worker shortages and intensifying wage pressures became more widespread. Farmers were still having difficulty repaying bank loans due to low commodity prices. Corn planting in the District was nearly finished at the end of May while soybean planting was 80 percent completed.

**Consumer spending.** Retailers indicated that sales results in May were in line with or slightly above their expectations, and a few contacts suggested that price discounting was not as big a factor in driving sales as it had been in recent months. Home-related items—furniture, lawn and garden, draperies, etc.—continued to receive a boost from exceptional housing activity. Apparel sales were also strong despite some weather-related softness in May. Discounters again appeared to fare better than general merchandisers, although sales growth had slowed somewhat from earlier in the year. A few retail chains with a national presence suggested that sales gains in the Midwest were not quite as strong as in the rest of the nation. One contact at a large auto dealer group in the District indicated that the market for light vehicles remained exceptionally strong, as consumers' confidence in the economy remained high. There were a few signs that consumers' resistance to price increases had softened slightly. Auto dealers and some casual dining establishments were able to push through very modest price increases; and a few retailers suggested that strong sales results were "not as price-driven" as earlier in the year, although a few merchants did continue using promotions to move some apparel items.

**Construction/real estate.** Construction activity remained very strong in the District, particularly on the commercial side. Office vacancy rates continued to tighten in most areas with some new development taking place, mainly in suburban areas. Demand for light industrial space, especially distribution centers, remained strong and development was reportedly keeping

pace with that demand. The retail segment appeared to be the most vibrant of the commercial categories according to contacts, with “big-box” tenants driving the market. Sales of both new and existing homes continued to exceed most builders’ and realtors’ expectations, despite recent increases in mortgage interest rates. Many builders again expressed concern that severe shortages of labor were leading to project delays. Shortages of building materials, most notably wallboard, were not as acute in the Midwest as in other regions although there were scattered reports of rationing by suppliers. One major supplier to the construction industry noted that orders for trim (which is installed right after the wallboard) had not been cancelled or delayed, suggesting that shortages had not been causing significant delays yet. With exceptional strength in new home and commercial construction, however, this contact stated that severe wallboard shortages in the region were just a matter of time.

**Manufacturing.** Overall manufacturing activity remained robust in May, although softness in some major industries persisted. Appliance shipments, benefiting from the strong housing market, were well above last year’s record levels through May. Noting that exports were down and imports up, one contact suggested that strong appliance sales were due almost entirely to exceptional domestic demand. This contact also noted that confident consumers were increasingly opting for higher-quality items, improving producers’ profit margins. Automakers also pointed to consumer confidence as contributing to light vehicle sales in May that were the highest monthly results since December 1986. Heavy truck production was running near record levels as inventories remained very lean. One contact noted that demand for heavy trucks remained strong, although a slight softening in new orders had reduced backlogs from 12 months to about 9 months. According to this contact, a three- to four-month backlog is typical for the industry. Production at steel mills was again hampered by the inventory overhang noted in our last report, but one contact said that capacity usage at integrated mills was on the rise and prices were coming back a bit after declines earlier in the year.

**Banking/finance.** Overall lending activity remained brisk in May and early June, despite some slowing in consumer lending. With mortgage interest rates trending upward in recent weeks, most bankers reported a noticeable and expected drop in refinancing applications. With home sales remaining strong, however, there was no significant drop in mortgage originations. One major bank noted that asset quality on consumer loans was improving as a result of the strong wave of refinancings earlier in the year and in response to some slight tightening of

lending standards. Business lending activity was generally described as strong and steady, with little if any noticeable change in momentum. While there were some scattered problem segments (for example, loans to firms in the steel, agriculture, and energy industries), overall asset quality on commercial loans remained very good, according to most bankers. Competition for quality commercial loans remained intense, keeping margins narrow, and a few bankers noted that the industry had “taken a step back” by slightly lowering lending standards.

**Labor markets.** The region’s labor markets remained much tighter than the nation as a whole, intensifying pressure on wages and hampering businesses’ expansion plans. Increased wages for information technology and administrative/clerical occupations were cited most often by contacts, but reports of broad-based wage pressures were more frequent than in our previous reports. One provider of temporary staffing services indicated that wages for administrative help had increased by 25 percent since the beginning of the year—costs that were passed along in large part to their customers. This firm was anticipating another price increase in June. Reports that severe shortages of labor were hampering economic growth also became more widespread since our last report. Builders and contractors suggested that shortages of qualified workers are more likely to cause project delays than the materials shortages noted earlier in this report. Contacts in metropolitan areas throughout the District reported that significant shortages of labor were limiting their ability to attract new businesses to their areas. A national survey showed that employers in the Midwest remained more optimistic about their hiring plans than their national counterparts and contacts at temporary help firms suggested that orders remain very strong with no signs of softening.

**Agriculture.** A recent survey of District agricultural bankers showed that farmland values during the three-month period ending April 1 rose in Michigan and Wisconsin, declined in Indiana, and were unchanged in Illinois and Iowa. On average, cash rental rates paid this spring were unchanged from a year earlier. Bankers reported that farm loan repayments slowed relative to last year as grain prices continued at low levels and milk prices fell. Hog prices increased to a near breakeven point for producers in early May but had retreated somewhat by early June. Corn planting in the District was all but finished by the end of May, while soybean planting was nearly 80 percent completed.

**EIGHTH DISTRICT - ST. LOUIS**

**Summary**

The District economy continues to exhibit strong growth. Retail sales were up between 4 and 5 percent from a year earlier, meeting most contacts' expectations. Auto and light truck sales were not as brisk, but have showed renewed strength recently. Manufacturers and other businesses continue to report growth in demand, which, in some instances, they are unable to meet because of persistent labor shortages. Signs of growing upward wage pressures are emerging, as the strong demand for labor shows few signs of tapering off. Residential real estate markets continue to boom throughout the District, while strong demand and shortages of available homes are driving up prices in some regions. District loan demand and credit conditions have remained essentially unchanged over the past few months. Supported by good soil moisture and ideal growing conditions, the spring planting proceeded as planned in most areas.

**Consumer Spending**

District retailers reported that sales in April and May were up on average between 4 and 5 percent compared with one year earlier. Only one-fourth of those surveyed said growth was below expectations. Home furnishings, appliances, electronics, and home and garden products were the most popular purchases. Nearly all respondents reported that inventories are currently at desired levels; moreover, they do not plan to boost inventories later this year in preparation for Y2K. Contacts expect sales to increase in the second half of the year, but do not anticipate price increases.

District auto dealers reported that sales, after a somewhat sluggish start in May, picked up by the end of the month. Some GM dealers noted that a lack of inventory of popular models, particularly pickup trucks, hampered sales. Other dealers reported that inventories are at desired levels. Only one contact noted holding extra inventory because of the then-pending truckers' strike. Most dealers expect vehicle sales by the end of the year to be up moderately from last year.

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

District contacts continue to report strong economic conditions. Orders for many products, such as manufactured homes, copper tubing and electrical equipment parts, continue to grow at a brisk pace, although not all demand can be met because of an ongoing shortage of qualified employees. Suppliers of building materials continue to report solid growth because of the booming construction industry. Poultry processors reported a rebound in sales and profits in the past few weeks and expect this trend to continue through the summer. Many contacts, however, noted strains on profit margins because of increasing operating costs that cannot be passed along to customers in the current competitive environment. Labor costs are the biggest concern for most contacts. In one instance, for example, a maker of home appliances has reportedly budgeted a 5.5 percent wage increase for the upcoming fiscal year.

The FedEx and UPS hubs continue to attract distribution centers to the region. Several firms, including Amazon.com and an apparel manufacturer, have announced plans to open new distribution warehouses in the coming months. The weak farming sector, however, has led to reduced orders for farm equipment. One producer has eliminated overtime and cut its work schedule back from a seven-day to a five-day work week because of falling demand. Because Boeing did not win new contracts for its F-15 fighter, about 7,000 jobs at its St. Louis plant will be eliminated as production is phased out by 2001. Some analysts believe, however, that this layoff might help the region attract businesses that had previously been reluctant to come because of a shortage of qualified workers.

### **Labor Market Conditions**

The demand for labor remains robust in the District's four major cities, according to Manpower's employment outlook survey for the third quarter of 1999. On average, about a third of the firms surveyed in Little Rock, Louisville, Memphis and St. Louis expect to add employees in the upcoming three months—slightly exceeding the rate from a year earlier—while about 8 percent plan

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to reduce their workforces. Of the four cities, Little Rock and Memphis had the largest shares of firms seeking to hire additional workers.

#### **Real Estate and Construction**

Sales of new and existing homes remain strong throughout the District. In some parts of the District, sales are up more than 10 percent from a year earlier. In fact, many markets are experiencing a shortage of available houses, leading to price increases and quick sales. Through April of this year, residential construction permits outpaced last year's levels by 10 percent or more in almost all of the District's metropolitan areas. Many nonresidential real estate agents believe that new office construction may be getting ahead of demand, despite low vacancy rates in most regions. The market for industrial/warehouse space remains tight, with regional vacancy rates well below the national average.

#### **Banking and Finance**

A recent survey of District senior loan officers indicated no change in standards for approving commercial and industrial (C&I) loans to large, mid-sized and small firms. A couple of respondents noted, however, that they had recently increased the premiums charged on riskier C&I loans. Demand for C&I loans was reportedly unchanged. In fact, demand and credit standards remained unchanged for commercial real estate loans, home mortgage loans, consumer installment loans and credit cards.

#### **Agriculture and Natural Resources**

Most of the District is experiencing ideal growing conditions, although parts of Kentucky and Mississippi could use some rain. Planting of the major crops, which was aided by favorable moisture conditions, came off without a hitch in most areas. Accordingly, crop conditions appear to be in good-to-excellent shape in most parts of the District. About a third of the wheat crop has been harvested in Mississippi, with early reports suggesting above-average yields.

## NINTH DISTRICT--MINNEAPOLIS

As summer approaches, the overall Ninth District economy continues to expand, although natural resource-based industries are still struggling. The economy remains robust for construction, consumer spending and manufacturing; consumers continue to spend and many businesses are expanding. However, low commodity prices persist in depressing farm income and curbing metal mining. Overall labor markets remain tight and in some cases businesses are paying more to retain workers.

### **Construction and Real Estate**

Construction and real estate retains its momentum. The strong housing market in Minneapolis-St. Paul boosted home prices 10 percent in April compared to a year earlier. Homebuilders are very optimistic; year-to-date housing units authorized were up 62 percent through April in South Dakota, up 24 in North Dakota and up 22 percent in Minnesota.

Other construction remains strong. Plans for \$80 million in new construction are set for downtown Duluth, Minn., according to an advisory council member. Bank directors report strong construction spending in Billings, Mont., and Fargo, N.D. The state of Montana is expected to pay contractors a record \$200 million this summer for roadway improvements, 16 percent higher than the previous record. However, contract awards through April were down slightly from year-ago levels for the Ninth District.

### **Consumer Spending and Tourism**

Consumer confidence is keeping retail sales vigorous and summer tourism prospects bright, as well as boosting merchandise and auto sales. Consumer spending is at last year's strong levels and auto dealers report steady sales in Montana. Mall sales are running 13 percent ahead of a year ago in Eau Claire, Wis., and are up 15 percent from year-earlier levels at a Minneapolis mall. However, small communities dependent on agriculture still show signs of softened sales.

Not only are people rushing to the malls, they are planning to visit vacation spots throughout the district this summer. The Montana tourism office predicts a 3 percent increase in visitors for 1999. Tourism businesses in Minnesota are optimistic for the summer season, especially along the north shore of Lake Superior, and Internet inquiries are significantly increased over a year earlier in South Dakota. Inquiries on tourism

activities in the Upper Peninsula of Michigan are at record levels, according to a tourism official.

### **Manufacturing**

Manufacturing in the district remains robust with several major manufacturers reporting higher levels of sales. As a result, district manufacturing shows signs of output expansion and productivity increases. A bus manufacturer is opening a new manufacturing plant in central Minnesota. A tool manufacturer in southern Minnesota is operating at capacity. A western Wisconsin plastic manufacturer is expanding capacity and an equipment manufacturer reported increased investment and productivity. A North Dakota food processor expanded its manufacturing capacity. An ethanol plant is under construction in South Dakota. Several other major district manufacturers noted continued improvement in productivity.

### **Mining and Energy**

Metal-based mining industries remain depressed. In response to low metal prices and environmental legislation, Montana mining employment in March declined two percent from year-ago levels. In addition, due to continued weak demand for domestic steel, a northern Minnesota taconite mine plans to shut down one of its pellet-making furnaces and terminate 168 workers. Moreover, U.S. iron ore inventories in March were 21 percent higher than year-ago levels. "Unless there is a miraculous turnaround later in the year, we're going to see some (more) cutbacks at iron ore operations," said an American Iron Ore Association spokesman.

Meanwhile, oil exploration activity remains below year-ago levels with only two rigs working in North Dakota and three rigs operating in Montana compared to 12 and four, respectively, a year ago.

### **Agriculture**

"Farm sales, liquidations and bankruptcies are on the increase," reported a South Dakota agriculture lender. Based on results of the Ninth District's second quarter (May 1999) survey of agricultural credit conditions, respondents reported that 31 percent of their agricultural customers were at their debt limit compared to 27 percent 12 months earlier. The second quarter 1999 survey revealed that 82 percent of respondents reported below normal levels of farm income compared to 71 percent of the second quarter 1998 survey respondents.

The reduced farm income is due to depressed livestock, corn, soybean and wheat prices. Many producers are still storing crops in hopes of future price increases. In addition, wet weather has delayed planting in many parts of the district. Some fields have standing water and may need to be replanted. The wet soil conditions also caused a small outbreak of anthrax in Montana.

### **Employment, Wages and Prices**

Labor markets remain tight, with scattered reports of wage and price increases. A major staffing and employment service reports that 48 percent of companies in Minneapolis indicate plans for increased hiring in the third quarter, while 2 percent expect decreases. Last year at this time 40 percent planned increases and 5 percent expected decreases. Job openings outside the Twin Cities area are also plentiful, according to a survey of purchasing managers. Employers will have to scramble to find employees to fill these positions as unemployment rates across the district continue to stay at low levels. Unemployment in Minnesota dipped to 2.1 percent in April, the lowest ever recorded in the state and the lowest in the country. In Duluth, Minn., 200 trade workers from outside the area are working on local construction projects due to the lack of local workers.

While detecting overall increases in wages proves difficult, there are reports of some increases. An advisory council member reports that wage inflation is a concern as new hires command higher salaries. Faculty raises at South Dakota's public universities averaged 7 percent for 1999. In the Upper Peninsula of Michigan, building trade union contracts were recently negotiated at 4 percent per year over the next three years.

General price increases are also difficult to spot. E-commerce and competition are making it hard to raise prices, reports a bank director. Although tourism prospects look bright, a tourism official in the Upper Peninsula of Michigan isn't anticipating increases of more than 5 percent for lodging or other tourism-related expenses. A large manufacturing company in the Minneapolis-St. Paul area reports level input prices.

## TENTH DISTRICT - KANSAS CITY

**Overview.** The district economy remained solid in May but appears to have slowed from the rapid growth of recent years. Extremely tight labor markets in much of the district may be contributing to the slowdown. Retail activity slowed following strong performance earlier in the year, and construction also cooled from the burst of activity in March and April. In contrast, manufacturing activity improved considerably from the sluggish conditions experienced in the recent past, and energy activity finally picked up in response to the recent increases in oil prices. In the farm economy, the winter wheat crop remained in good condition, but losses continued for many livestock producers. Although labor markets in most of the district remained very tight, wage pressures eased somewhat from previous surveys. Retail prices continued to edge up, as did prices for construction materials, especially sheetrock. After a long period of decline, prices for several manufacturing materials also began to rise.

**Retail Sales.** Retail activity in the district slowed somewhat in May after performing exceptionally well from the beginning of the year through the Easter season. Still, sales remained well above year-ago levels. Home furnishings enjoyed another strong month of sales following the construction boom in March and April. The slower overall sales volume led store inventories to creep up in May. Most managers were not especially worried, however, since expectations for activity over the next three months remained robust in the wake of continued strong consumer confidence, low unemployment rates, and persistent income gains. Expecting higher sales in the near future, many stores plan to continue building inventories into the summer. Automobile sales were weaker in May than in previous months but stayed above year-ago levels. Trucks and SUVs continued to lead in sales growth, but truck dealers in general and GM dealers in particular complained of difficulties obtaining enough of these vehicles to meet demand. Overall, car dealers were unhappy with current inventories, with most trying to expand in anticipation of strong sales in coming months.

**Manufacturing.** Tenth District factory activity showed marked improvement in May, as manufacturing conditions strengthened at the national level and steady progress in Asia and a fast recovery in Brazil seemed to reduce the difficulties plants were facing in their export markets. Capacity utilization at

district factories nearly matched the high levels posted last summer and was much higher than in our previous three surveys. Most manufacturing materials remained generally available in May, but producers of construction materials expressed concerns about the future availability of some inputs if building demand remains high. Input lead times were largely unchanged, but lead times for several finished products, such as sheetrock and brick, continued to edge up. Inventories at district factories were similar to the recent past, with the majority of managers remaining satisfied with current stock levels.

**Housing.** Construction activity slowed last month from unusually strong growth in March and April, but builders remain overwhelmingly optimistic about the future. The destruction caused by the recent tornadoes in Oklahoma and Kansas has created additional demand for construction services in those states; and with consumers remaining upbeat about the economy, builders anticipate another burst of activity in coming months. New home starts increased at a much slower pace in May than in the previous two months but remain comfortably above year-ago levels. Problems with sheetrock availability continued to mount, pushing prices for construction materials up for the third straight survey. The additional demand created by the tornadoes has most builders expecting continued availability problems in the future. Home sales in the district were steady in May, remaining just above year-ago levels. Inventories of unsold homes were largely unchanged, staying at moderate levels. Mortgage bankers reported another decline in refinancing activity last month, with overall mortgage demand falling further below year-ago levels. But most lenders cautiously share builders' enthusiasm about the future and expect a rise in demand in coming months.

**Banking.** Bankers report that loans and deposits both edged up last month, leaving loan-deposit ratios unchanged. Demand rose for residential construction loans, commercial real estate loans, and commercial and industrial loans. Demand for home mortgage loans slowed. Small increases in demand deposits, NOW accounts, and large time deposits were partly offset by a drop in small time deposits. All respondent banks left their prime lending rates unchanged, and all but a few left their consumer lending rates unchanged last month. Although most banks expect to maintain their prime rate and consumer lending rates over the near term, a few banks expect to raise these rates in the near future. Lending standards were unchanged.

**Energy.** District energy activity finally improved in May after nearly a year and a half of steady decline. The rig count rose 7 percent in May, responding to the recent jump in oil prices. Still, the number of rigs operating in the district remained more than 35 percent below year-ago levels. The price of West Texas Intermediate crude oil continued to rise in early May, reaching nearly \$19 per barrel, but began to taper off by the end of the month. The price for the month as a whole was almost 20 percent higher than in the previous year. Natural gas prices also increased in May, rising above year-ago levels for the first time since last summer.

**Agriculture.** The district's winter wheat crop was in good condition, with average yields expected in most areas. Spring plantings fell slightly behind schedule due to recent excessive rains in some areas of the district. Losses continued to pile up for hog producers in the region. While many of the district's small hog producers have liquidated, most medium- and large-sized producers continued to operate in spite of the severe toll of the last six months. The weak farm economy has led to a slowdown for many mainstreet businesses through rural parts of the district. Despite some hitches earlier this year, district bankers report a generally smooth process in obtaining Farm Service Agency guarantees for their weakest farm loan customers.

**Wages and Prices.** Labor markets remained very tight in most of the district in May, especially for construction workers, but wage pressures eased somewhat after increasing in the two previous surveys. Builders continued to face the biggest difficulties finding capable workers, with framers especially in short supply. Among retailers the biggest needs remained entry-level workers and sales associates, while for manufacturers, general production workers became the toughest to find. Wage pressures eased slightly across the board but remained vitally present. Retail prices continued to edge up in May and are expected to rise slowly in coming months. Prices for some manufacturing materials, especially oil, rose considerably from our last survey, although most managers expect a leveling off in the near future. Sheetrock prices jumped again in May and most builders expect further increases in prices for construction materials.

**ELEVENTH DISTRICT--DALLAS**

In May and the first week of June, the Eleventh District economy continued to expand at roughly the same pace reported in March and April. Most business service firms continued to report strong activity, and retailers said sales growth was still strong. Construction activity and concerns about overbuilding were up slightly over the past six weeks, however. Contacts at manufacturing firms and financial institutions reported little change in activity. Energy activity has not increased with higher oil prices, according to contacts, although optimism is picking up. Agricultural conditions have been mostly favorable.

**Prices.** Over the last six weeks, there were more reports of price increases than price declines. High levels of construction have led to very high land prices, according to contacts, and shortages of bricklayers, framing labor and building materials, such as lumber. Drywall is being allocated to contractors based on the amount they purchased last year, and prices surged as much as 30 percent following the Oklahoma tornadoes. Higher building costs and strong demand have pushed new home prices up 5 percent to 7 percent over the past year. Shortages of labor and inputs have also caused new home construction to be delayed by one to three months, and some contacts say the quality of construction has been allowed to decline to help builders offset the rising cost of inputs. In the service sector, contacts say hiring remains difficult, and wages are up for truckers, secretaries, legal assistants and workers with technical skills. Service firms reported less resistance to fee increases in May and early June, than in the six weeks prior, particularly at legal and temporary firms. Some retailers said smaller markdowns resulted in a slight increase in final selling prices over the last six weeks. Some of the retailers who benefitted from falling prices for Asian products say those prices are expected to increase slightly over the next six months. In May, prices were up for ethylene-based petrochemicals, as already low inventories of ethylene were drawn down following planned and unplanned outages in April and May. Prices for these chemicals are not expected to fall until inventories are rebuilt, which contacts believe will take much of the rest of the year. Heavy inventories of ethanol, styrene and polystyrene are

keeping other petrochemical prices from increasing even though feedstock costs, such as oil and natural gas, have risen. Stiff competition and dealer incentives are driving down retail prices for new cars. This is putting downward pressure on used car prices, which have fallen for the last four months.

**Manufacturing.** Manufacturing activity remained at roughly the same level as reported in the last beige book. Demand remains very strong for construction-related manufactured products, such as cement, brick, lumber and metals. Demand for aluminum surged over the last month, which one contact suggested may be because customers were stocking up in anticipation of price increases. Sales continued to be strong for electronic and communications equipment. Producers of corrugated boxes also reported that sales were still strong, but demand for printing paper was weaker than three months ago. Refiners say profit margins fell over the past couple of weeks, as refineries moved production into high gear and inventories filled up. Refineries along the Texas and Louisiana Gulf Coast have operated at 100 to 105 percent of rated capacity over the past six weeks. Apparel manufacturing activity remained mixed, with demand increasing only for those who do not face significant import competition.

**Services.** Most business service firms continued to report strong activity over the past six weeks. Demand for telecommunications, legal and temporary services were still strong, and temporary firms said demand for their services from the manufacturing sector was up slightly. Demand for shipping services was weaker than reported in the last beige book, according to contacts. Trucking companies reported slower demand growth than over the past couple of years, and rail cargo volume was down. A large rail firm announced plans for layoffs and a reduction in orders for capital equipment. A contact suggests this might induce similar announcements from other rail companies in the future.

**Retail Sales.** Retailers said sales growth continued to be strong in May. Sales were very strong in most of the region's major metropolitan areas, with some stores posting double-digit increases in the Dallas-Fort Worth Metroplex. Some retailers reported flat sales growth in Houston, however, and the region's rural markets did not do well, according to contacts. Auto dealers said demand was still strong in May, particularly for sports-utility-vehicles and trucks.

**Financial Services.** Contacts at financial institutions report little change in activity, with continued strong lending, and “good” business conditions and profits. Contacts say consumer lending continues to fare the best, with solid margins. According to bankers, competition for commercial lending remains intense. Lending in rural areas continues to be slow because of weak agricultural markets.

**Construction and Real Estate.** Construction activity increased slightly over the past six weeks, fueled by strong home sales, retail construction and “booming” school construction. Shortages of labor and materials, particularly residential and commercial drywall, are still restraining building activity. New home sales, starts and traffic through model homes were up from last year. Existing home sales continued to surge, with homes selling quickly; some before they are listed. Hotel construction has slowed, however, which pleases contacts who say the hotel market is overbuilt. Heavy supplies and slow business travel have pushed down hotel occupancy rates. Commercial real estate activity remains slow. Demand for office space is still “good,” but one contact summarized the overbuilding concerns of many by saying “we’re holding our breath,” noting that anything that hasn’t been started is being reevaluated. Another contact said sales of office buildings have slowed and expressed uncertainty about future prices. Contacts say small office and industrial buildings are in short supply, however.

**Energy.** Energy activity has not increased with higher oil prices, although there is increased optimism about the second half of this year because producers expect the number of wells being drilled to increase. Some producers believe there is the potential for a big bounce back in drilling activity, since drilling programs are running behind the plans made early in the year, before oil prices rebounded. Still, all contacts qualified any optimism by saying that oil prices will come down as fast as they went up if OPEC does not hold together.

**Agriculture.** Favorable weather conditions aided crop development, planting and harvesting activities in most areas in May. Still, low price forecasts for most crops continues to dampened some of the enthusiasm for planting, particularly cotton. Range and livestock conditions were good.

## TWELFTH DISTRICT — SAN FRANCISCO

Summary

Reports from contacts indicated robust economic conditions in the Twelfth District during the most recent survey period. Sales were brisk for retailers and providers of services to consumers and businesses. Manufacturing activity proceeded at a moderate pace, and contacts reported a mild pickup in export demand. Conditions in the agricultural sector were somewhat weak. Activity in real estate and construction markets remained at high levels in most areas, and financial institutions reported strong demand for credit. Wages and prices exhibited limited movement overall, although increases were noted for some types of workers and some products.

Business Sentiment

Contacts generally are optimistic about the expected performance of the national economy and their respective regional economies during the next year, although they are concerned that inflation will rise. Nearly all of the contacts expect growth in national GDP to equal or exceed its long-run average pace, and two-thirds expect the national unemployment rate to remain at its current level; both figures reflect substantially greater optimism than was evident in preceding survey periods. However, the percentage of contacts expecting higher inflation has risen from about one-quarter early this year to three-quarters now. Nearly two-thirds of the contacts expect the pace of economic growth in their region to exceed the national pace, and the percentage expecting improvement in their region's outlook for foreign trade has risen to one-half, after dropping nearly to zero in mid-1998.

Retail Trade and Services

Retail sales were rapid overall, although contacts provided scattered reports of slight

slowing in a few states. Automobiles and light trucks sold at a good clip in most areas of the District, and prices were flat or declined a bit. Throughout California, sales were rapid for all types of consumer items, with similar reports provided by contacts in Arizona, Washington, and Oregon. By product, the strongest sales in the District were reported for home furnishings and home electronic items. However, several respondents in Utah and Nevada noted that retail sales slowed relative to the previously rapid pace in those states, especially for some "big ticket" consumer durables and luxury goods.

In regard to services, general reports indicated that sales to businesses and consumers continued at a rapid pace. Demand was strong for communications and utility services. Export traffic through Southern California ports picked up a bit further. The sole weak report was for the tourist trade in Utah, where airport travel and hotel occupancies declined. Regarding labor costs at retail and service establishments, reports indicated annual wage increases in new union contracts and for workers in general that were in the 3 to 3½ percent range or below. Price increases were limited in general, with the exception of rising health care costs and prices for pharmaceuticals. Gas prices fell somewhat in California but remained at elevated levels.

### Manufacturing

Reports indicated a moderate pace of activity in the manufacturing sector, with some evidence of rising foreign demand. Demand for Pacific Northwest lumber has been "excellent," and paper and pulp processors there benefited from an increase in demand from East Asia. Several contacts noted increased sales of semiconductors and semiconductor manufacturing equipment due to rising world demand, and high-tech manufacturers in some areas reportedly have begun to expand their work forces. Conditions in the chemical manufacturing sector also

improved and producers of biotechnology products faced continued strong demand. In contrast, Boeing's outlook for international sales remained weak, and activity by manufacturers of women's apparel slowed.

#### Agriculture and Resource-related Industries

Agricultural producers faced somewhat weak demand and low sales prices. Reports from California, Washington, and Oregon indicated that farmers were hampered by weak export demand, and sales prices have remained low as a result. Planting and growing conditions were mixed. Poor weather adversely affected grain and vegetable crops in Oregon, but conditions have improved in California's Central Valley, which reportedly is recovering from the impact of the freeze that hurt growers in late 1998.

#### Real Estate and Construction

Demand for real estate and new construction remained high in the District, although there were scattered reports of slight cooling in states other than California. Home construction and sales proceeded at a vigorous pace throughout California. The markets for commercial, industrial, and office space also were very active in the state, with continued low vacancy rates reported in most areas and rising rents observed in a few; strong demand has even spurred construction of new office buildings in the downtown area of San Francisco. The markets for residential and nonresidential real estate were vibrant in most other states as well. However, there were scattered reports of slight cooling in Washington, Oregon, and Idaho, and several contacts noted that residential real estate markets have loosened a bit in Utah. In Hawaii, construction activity remained torpid, although falling home prices reportedly spurred rising sales. Reports from several states indicated rising construction costs due to shortages of building

materials such as drywall and skilled labor such as carpenters, but no substantive effects on overall construction activity were noted.

Financial Institutions

Contacts at banks and other financial institutions, such as venture capital firms, reported strong demand for credit and relatively good supply conditions. The only exceptions were in Hawaii, where activity in all loan categories was weak, and in Utah, where higher mortgage rates reportedly reduced mortgage refinancing activity.