For use at 2:00 p.m., E.S.T.
Wednesday
January 20, 1999

Summary of Commentary on

Current Economic Conditions

by Federal Reserve District

January 1999

SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICTS

JANUARY 1999

TABLE OF CONTENTS

SUMMARY

According to reports from business contacts in the twelve Federal Reserve districts, most regions are showing solid economic growth overall, despite mixed or weak results for individual sectors in some areas. New York, Philadelphia, and Richmond report a pickup in activity recently, while Boston, Atlanta, Cleveland, Kansas City, and San Francisco indicate that the pace of growth for at least some sectors has slowed.

Most districts report generally stable or declining prices for both producers and consumers, but exceptions exist. For example, home prices are rising in some districts, fees for services are said to be up in Dallas, and Boston mentions price increases by selected manufacturers. Energy and most agricultural prices are low by historical standards. Retail discounting just before Christmas and around the turn of the year was more extensive than usual in some areas.

Reports from all districts mention labor market tightness, with Atlanta, Chicago, and Richmond recording heightened wage pressures in some sectors and St. Louis citing increased worker "poaching." However, the Kansas City, Boston, and San Francisco districts say some extreme shortages have eased.

Looking forward, business contacts in most districts remain optimistic about 1999, especially the first half. Philadelphia and Atlanta indicate that some contacts expect business activity to accelerate early this year. However, respondents in most districts expect somewhat

---

Prepared at the Federal Reserve Bank of Boston and based on information collected before January 11, 1999. This document summarizes comments received from business and other contacts outside the Federal Reserve and is not a commentary on the views of Federal Reserve officials.

slower growth in 1999 than in 1998.

Consumer Spending

Most districts report that retail sales grew at a moderate pace during the holiday period. By exception, the Kansas City, Philadelphia, and Minneapolis districts experienced brisk sales growth. Respondents in the Boston and Philadelphia districts cite mixed sales results, with some sectors showing strong activity and other sectors experiencing softness. Only in the Atlanta district do contacts report weak holiday sales, up only slightly from a year earlier.

Retailers in many districts report a surge in sales late in the season, led by extensive price discounting, which brought inventories to desired levels. Only in the St. Louis district are retail inventories said to be higher than desired. Sales of consumer durables are reportedly strong in every district, with the most robust results in home appliances, home furnishings, consumer electronics, and automobiles. By contrast, unseasonably warm weather in most of December weakened sales of winter apparel and tourist activity in many districts; some districts report a pickup in winter merchandise sales with the advent of cold weather. Discount retailers reportedly profited more from the late buying surge than did department stores.

There is little evidence of price pressures at the retail level and most districts say that retail wages are rising moderately. In almost all districts, retailers discounted extensively, but where consumer demand was very strong, less discounting occurred, leaving consumer prices about flat.

Manufacturing

Many districts report mixed results in manufacturing. On the whole, Dallas notes continuing expansion, and Philadelphia and St. Louis indicate some recent pickup. By contrast, New York and Kansas City report overall declines, while Atlanta indicates that factory activity remains sluggish.

The Cleveland and Chicago reports cite strong production and expectations of continued strength in the motor vehicle industry. Respondents in Chicago, St. Louis, and San Francisco indicate positive trends in construction-related manufacturing; in Dallas this sector is flat, although orders for cement remain at a high level. Boston and San Francisco cite medical equipment as a bright spot.

Various districts mention depressed revenues for producers of paper, steel, agricultural equipment, and oil-related products. Boston and Dallas report that the semiconductor industry is doing substantially worse than a year ago but seems poised to stabilize or improve in coming months. Almost every district cites examples of manufacturers whose business is being hurt by weak exports, particularly to Asia.

In most cases, industrial prices are flat or falling. Steel and paper prices reportedly are under intense downward pressure as a result of import competition (and, in the case of paper, weak demand). Prices for refined petroleum and petroleum derivatives remain low or have fallen, and Dallas reports that full capacity utilization has resulted in "huge" inventories of home heating oil. Chicago and Kansas City mention price increases for some construction materials.

Manufacturers face disparate labor market conditions across the country, according to district summaries. For instance, Chicago indicates ongoing softness in the demand for manufacturing help, while San Francisco says that filling vacancies remains difficult. On the whole, pay pressures in manufacturing seem unchanged or slightly more moderate than in the recent past. Some workers are experiencing a weaker job market because of recent layoffs, especially in trade-sensitive sectors or regions.

Business Services

Districts reporting on the business services sector describe an extremely tight labor market. Most districts also report both wage increases and stable selling prices. In Cleveland, New York, and Dallas, temporary employment firms are having difficulty finding workers to fill their orders. Customer service workers, secretaries, and receptionists are in high demand in Cleveland. In Dallas, contacts report strong demand for system programmers and other computer-related workers. Though job growth in business services appears generally strong, some exceptions exist. Contacts at temporary employment firms in Richmond and Chicago note ongoing softness in the manufacturing sector. In both Richmond and San Francisco, service activity, including legal and accounting, was flat.

Construction and Real Estate

Many districts report unusually high levels of real estate activity in November and December. Residential construction did not experience typical slowdowns in December; unseasonably mild winter weather and favorable demand conditions are cited as explanations. High levels of new home construction are reported by the New York, Cleveland, Richmond, Chicago, St. Louis, Kansas City, Dallas, and San Francisco districts. Chicago and Minneapolis are experiencing very strong markets for new construction, with large increases in the number of permits and new home sales. Commercial development is also robust in the Chicago and San Francisco districts. Labor markets are tight in several districts, with especially short supplies of skilled tradesmen, such as plumbers and electricians.

Existing home sales are strong as well. Parts of the Boston, New York, and Chicago districts tallied record sales of existing homes in November or December. Other districts, including Richmond, St. Louis, and San Francisco report high but stable levels of sales. Small or moderate increases in home prices are reported by Boston, New York, Richmond, and St. Louis.

The commercial real estate market is moderately active. New York and Richmond report small increases in office rental rates. Office vacancy rates are increasing slightly in the tight Manhattan market, but declining in Minneapolis-St. Paul and the Richmond district.

Financial Services

Districts reporting on banking activity indicate that demand for commercial loans is mixed. Dallas reports that an earlier slowing in commercial lending has abated, while New York notes a seasonal decline in commercial lending in December. Business lending expanded at a healthy pace in Atlanta. Some tightening of underwriting standards is reported by Philadelphia, San Francisco, and New York. Some banks in Cleveland note adverse effects of the Asian crisis on their industrial customers. Most districts report continued strong demand for residential mortgages. Refinancing activity was especially strong in Atlanta while Philadelphia reports large increases in mortgages to finance newly built homes.

Agriculture and Natural Resources

Agriculture, oil, and mining continue to face financial pressures. According to contacts in the Chicago, St. Louis, Minneapolis, Kansas City, and San Francisco districts, low prices for cattle, hogs, wheat, feed grains, cotton, and some vegetables have been squeezing profits and, in some cases, failing to cover production costs. Large domestic supplies, falling demand for feed stocks, and reduced exports are reportedly responsible for the low prices. Hog farmers have been particularly hard hit; hog prices in mid-December were at 30-year lows and nearly 60 percent below late 1997 levels, although Chicago reports that hog prices recovered modestly in early January. In general, unless prices improve, many farmers expect to lose money in 1999, and agricultural lenders in the Minneapolis and Kansas City districts express some concern about future loan repayments and borrower solvency. By contrast, dairy farmers are facing the most favorable milk-to-feed-cost ratios in years. Looking ahead, some contacts in the San Francisco district report a pickup in export orders, especially for meat. The late December freeze did little apparent harm to winter crops except in California, where the cold damaged 50 to 70 percent of the citrus crop.

Conditions in energy and mining worsened late last year, according to respondents in Atlanta, Minneapolis, Kansas City, and Dallas, despite the cold snap in late December that pushed natural gas prices up slightly. Contacts in Minneapolis, Kansas City, and Dallas report that U.S. rig counts are near post-World War II lows. The rig count has fallen 34 percent, year-over-year, in the Kansas City district and by even larger percentages in Montana and North Dakota. Energy producers have cut exploration, capital spending, and production plans; demand for capital equipment and oil services is deteriorating, and, in the Dallas district, energy sector layoffs are widespread. Contacts in the Minneapolis district also report that copper prices are near shutdown levels at Montana mines, while Minnesota and Michigan iron mines expect to see significant drops in output in 1999 because of increased imports of iron ore and finished steel.

Manufacturers generally expect their revenues to increase in 1999, although some believe their business will be constrained by weaker growth in the economy or by competition. Several mention that customer reactions to Y2K could result in volatile patterns over the course of the year.

Residential Real Estate

The residential real estate market in New England is doing well. Most contacts report that the last quarter of 1998 was active and busy. Greater Boston and adjacent areas (southern New Hampshire and northern Rhode Island) are especially strong. Massachusetts tallied a record number of sales, with the total number of homes sold through November 1998 already above the full-year total for 1997; condominium sales were particularly strong. Contacts say the average year-end sale price was 9 percent higher than the year-end average in 1997, although some of the increase reflects a shift toward bigger homes.

Housing markets in the rest of New England are less consistently strong, although all contacts report an increased level of activity in the last quarter. The number of sales did not increase much outside Massachusetts, in part because of shortages of inventory in many regions, especially Rhode Island and Vermont. Most contacts expect residential markets to remain strong as long as interest rates stay at their current levels.

Investment management

The latest data report that stock mutual funds experienced a 6.7 percent increase in total assets in November 1998 compared to the previous month. Inflows in November were more than five times higher than in October, largely because of a substantial decline in redemptions and exchanges by investors. Anecdotal information indicates that the strength in stock mutual funds continued through December and early January.

Mutual fund respondents in the First District increased employment in the fourth quarter of 1998 and plan to add further in 1999; most of the increase is for customer service representatives. Respondents note some easing of previously reported labor shortages, except for technology personnel.

SECOND DISTRICT--NEW YORK

Economic growth in the District has picked up further since the last report, with very few signs of upward price pressures. Although retailers report mixed sales results for December, all experienced a strong pickup toward the end of the month, buoyed by cold weather and steep discounting; inventories were generally said to be in good shape in early January. The housing market continued to gain momentum in the fourth quarter, led by a strong rebound in New York City's co-op and condo market, continued brisk activity in the suburbs, and a marked recovery in sales activity in upstate New York. Manhattan's office market remains tight, although vacancy rates edged up from cyclical lows recorded in the third quarter; rents continued to rise, albeit at a slower pace than earlier in the year.

Regional surveys of purchasing managers indicate a widening divergence between the manufacturing sector, which weakened in December, and non-manufacturing sectors, which continued to strengthen. New York City purchasers note that upward cost pressures for most contracted services moderated in December, while prices of other goods and services were flat. Finally, local banks report a normal seasonal decrease in loan demand, tightening credit standards, and declining delinquency rates.

Consumer Spending

Retailers indicate mixed sales results for December. Most retailers report that sales were sluggish in the first three weeks of December, but surged late in the month, buoyed by steep discounting and a long-awaited cold snap. Discounters registered particularly strong same-store sales gains compared to a year earlier, ranging from 4 to 9 percent; sales at general merchandise chains varied widely but gains were more modest on average. A survey of small New York State retailers indicates that average sales rose 3-5 percent from a year ago, buoyed by a "last-minute rush" and "drastic price cuts by merchants." Sales of home-related merchandise were generally strong; however, sales of toys lagged. While mild weather for most of the holiday shopping season had raised concern about inventories of winter outerwear, most merchants were satisfied with early-January inventory levels.

Construction & Real Estate

The District's housing market showed further signs of strength in the fourth quarter. Single-family housing permits in New York and New Jersey continued to increase in November, but multi-family permits retreated a bit from October's extraordinarily high level. Total permits for the first two months of the fourth quarter were up 50 percent from a year earlier. More currently, homebuilders in New Jersey say that the housing market was unusually strong in December, with one contact saying it was the "best month ever," and another reporting "unexpectedly high traffic" during the normally slow Christmas-New Year's week. Also, contractors describe remodeling activity as "phenomenal."

New York State realtors report that sales of existing single-family homes were exceptionally strong in October and retreated only slightly in November, rising 9 percent above year-earlier levels. Year-to-date, sales are the strongest since 1988. Home prices were also firm in November, rising 6 percent above year-earlier levels. While the appreciation in home prices is mainly limited to the New York City area, sales volume is up strongly throughout the state. One contact in Rochester notes that "warm weather and low mortgage rates" contributed to strong improvement in the local housing market in the fourth quarter; he sees "no indication of a slowdown," aside from the normal cold-weather lull.

Revenues from New York City's mortgage recording tax were well above plan in November, reflecting strong conditions in the city's housing market. A major Manhattan real estate brokerage reports that the market for co-ops and condos improved sharply in mid-November and remained strong in December, with both sales and prices rebounding strongly in tandem with financial markets.

While Manhattan's office market remains tight, office vacancy rates edged up in both October and November, after trending down throughout the year; rents continued to increase, but at well below the double-digit pace experienced through most of 1998.

Other Business Activity

Regional purchasing managers surveys indicate a mixed performance. New York City area purchasers report that local manufacturing weakened sharply in December; however, they report a further acceleration in activity outside that sector. Upward price pressures for most contracted services moderated in December, though prices paid for computer consultants and temporary help continued to rise sharply; prices paid for other goods and services were little changed. Buffalo purchasing managers report some slowing in the local manufacturing sector in December, led by a steeper than usual seasonal decline in new orders; they also report steady to declining commodity prices. A manufacturing industry specialist in western New York notes that while large employers are still being forced to cut back, most small to mid-size manufacturers "look fine."

In New York City, tourism remains robust; hotel occupancy rates were slightly lower than a year ago in November but have held steady at an exceptionally high level since August, even after adjusting for seasonal variation. Moreover, average daily room rates are up more than 9 percent from a year ago and continue to rise briskly.

Financial Developments

According to a survey of senior loan officers at small and medium sized banks in the second district, the demand for commercial loans registered a normal seasonal decline in December, led by the consumer loan category. Refinancing activity remained stable over the past two months. Bankers report continued tightening in credit standards on all categories of loans—especially commercial loans and nonresidential mortgages. No banks eased their credit standards while 18 percent tightened them.

Interest rates on both loans (especially non-residential loans) and deposits continued their decline over the last two months. Delinquency rates continued to decrease for all loans, indicating both ongoing improvement in the quality of credit and seasonal factors.

THIRD DISTRICT - PHILADELPHIA

Economic activity in the Third District was moving up as the new year began. On balance, manufacturers reported a slight improvement in business conditions, although weak Asian markets continued to hamper recovery for some industrial sectors. Retail sales for the holiday shopping period met or came close to meeting most retailers' goals, and auto sales remained strong. Bankers generally indicated that lending to both consumers and businesses was increasing and that mortgage activity was still robust.

The outlook in the District is positive. Manufacturers expect orders to increase during the first half of the year, and they plan to step up capital spending. Most retail executives and auto dealers believe firm consumer confidence will support a continued high level of sales. Bankers expect further economic growth in the region this year; however, they believe the pace of expansion will ease somewhat compared to last year's.

MANUFACTURING

Manufacturers contacted in late December and early January noted some signs of improvement. Although most said business was steady, slightly more had recent increases in orders than decreases. In particular, manufacturers of metal products and textiles noted stepped-up demand. In contrast, chemical producers and equipment manufacturers reported continuing slowness, attributable in large part to persistent weakness in Asian economies. Despite the upturn in demand, order backlogs have remained unchanged. Area manufacturers have maintained steady employment.

The regions' manufacturers predict further improvement in the first half of the year. Nearly half of the firms contacted for this report expect orders and shipments to increase, twice the number that anticipate slower business. Capital spending is also forecast to grow, and increases in working hours are scheduled for the first and second quarters. Despite current downward pressure on industrial prices, the consensus among industrial managers surveyed at year-end is that prices will rise in 1999.

RETAIL

Sales for the Christmas shopping season met or came close to meeting most retailers' expectations of a 4 to 5 percent increase, in current dollars, over the 1997 period. Electronic items sold well, and the onset of cold weather in late December boosted sales of winter coats and other seasonal apparel, which had been languishing. Discount stores generally reported better sales increases than other types of stores, although the late surge in apparel sales helped some department stores come close to achieving their sales targets. Promotional price reductions appeared to be a bit more extensive this season than in the previous year, but inventories after the holidays did not appear to be significantly above planned levels.

Auto dealers reported a good pace of sales in December, above the rate in December 1997. Pickup trucks, sport utility vehicles, and minivans continued to sell strongly, and some dealers indicated that supplies of these vehicles have not kept up with demand. Dealers said the level of manufacturers' incentives remains high and low financing rates were common.

Both auto dealers and general retailers said consumer confidence seems high, and they expect consumer spending to stay strong. Some retail and banking contacts expressed concern that consumer debt might be approaching levels that would tend to curtail spending, but they did not foresee serious retrenchment as long as employers' demand for workers remains healthy and interest rates do not rise.

FINANCE

Bankers reported growth in both personal and business lending in December. Consumer credit expanded for seasonal shopping as well as auto purchases and for spending on home improvements. Some bankers reported that they were implementing more stringent credit conditions for personal loans, but they do not expect the tighter standards to limit loan growth significantly. Mortgage activity remained strong for both refinancing and purchases. Some bankers noted especially large increases in applications for mortgages for newly built homes.

Commercial and industrial loan demand has picked up, according to several bankers contacted in early January, although competition among banks and other lenders remained keen. Some commercial bank lending officers said companies seeking new or enlarged credit facilities were generally very well capitalized and were looking to establish financing arrangements in anticipation of expanding business this year. Overall, however, bankers indicated they and their business borrowers were expecting slower economic growth this year compared to last year.

FOURTH DISTRICT - CLEVELAND

General Conditions

The Fourth District economy continues to grow, though industrial activity has clearly moderated in a few industries. Most sectors and regions report strong production and steady income growth.

Finding enough workers to meet demand is the number one problem among temporary employment agencies. Although several agencies report increasing wages over the past month, they remain unable to fill all requests for workers. Workers with good communications skills have been in great demand recently; most agencies listed customer service positions in highest demand, followed by secretaries and receptionists.

Union wage patterns are mixed, but the majority indicate little, if any, change from the 3% average reported earlier. Other sources indicate a small upward movement in wage growth to about 3 ½%. Job security is still a major concern, particularly among steelworkers, for whom layoffs have increased sharply in the past month.

Most shipping firms expect moderate growth in 1999 after a robust 1998. Volumes last year were quite good, aided by burgeoning catalog spending. Area freight companies note that exports continue to wane, while imports have risen further. Shippers have seen some loss of business due to decreased steel production.

Construction

Residential and commercial construction remained unusually strong through the end of 1998, helped in part by mild weather. Wages seem to be holding steady in commercial construction, although labor shortages and upward wage pressure still exist in some residential construction trades. Residential builders note rising land prices, while materials costs have steadied recently. The consensus among District builders is that building activity will remain strong in 1999.

Industrial Activity

Manufacturing activity has varied widely by industry. Steel producers report that orders, which had fallen sharply since midsummer, appear to have leveled off. Demand remains quite strong, but foreign competition remains fierce and prices are under strong downward pressure. Like agricultural commodity prices, industrial commodity prices are still falling in a number of categories.

Capital goods producers indicate continued growth in orders and production, although at a more moderate pace than earlier in the year. Still, business activity in this sector remains quite good. Large truck orders remained very strong, and the orders backlog has grown to a record level. Production levels in this industry are likely to reach a near-historical high, and order books are full at least through mid-year.

Consumer Spending

What began as a somewhat sluggish holiday shopping season, rebounded sharply by year's end. Overall, holiday retail sales were generally characterized as strong and that strength appears to have continued after the Christmas holiday, although stores report no more promotions than in previous years. Inventory levels are reported to be about average. Furniture stores report good sales, with inventories and pricing about average for the season. Credit promotions have become more commonplace, however, due to increased competitive pressures.

Retailers maintain that the labor market is tight, and many continue to experience difficulty in finding qualified workers.

District auto dealers saw good-to-excellent new vehicle sales in December, with significant increases in sales volume over a year ago. Inventories were in line with sales expectations. Even General Motors dealers indicated that vehicle stocks had returned to normal following the strike-related shortages of the summer. The trend in used-vehicle sales was average-to-good last month, and generally above last December's sales pace.

Banking and Finance

District lending activity remains unchanged at a high level in most credit categories. Banks report a slight increase in consumer loans due to year-end car purchases. Banks also indicate that loan delinquencies are holding steady at a low level. Some District banks report adverse affects from the Asian economic crisis as industrial customers experienced falling prices and a slowdown in business growth.

Although some banks report tightening their credit standards, most indicate little change. Credit availability remains high. The spread between borrowing and lending rates has narrowed further and competition for borrowers remains intense. Still, respondents indicate that lending rates are appropriate for the degree of risk.

FIFTH DISTRICT – RICHMOND

Overview: The Fifth District economy expanded at a faster pace in the weeks since our last report, boosted by a pickup in consumer spending. Retailers reported busy stores and stronger-than-expected sales during December. Outside of retail, service sector activity was flat, held back in part by inclement weather in late December. Manufacturing activity was mixed; output growth tapered off, but employment picked up after dropping in November. Growth in commercial and residential real estate held up well and lending activity remained strong at financial institutions across the District. Cold and icy weather in late December hampered tourism in many areas, but revived ski resorts, many of which had opened later than normal because of mild temperatures early in the month. In labor markets, wage growth continued strong in retail and services, but slowed in manufacturing. Prices of both goods and services were little changed at most District firms.

Retail: Retail sales advanced at a stronger pace in December. District retailers reported better than expected shopper traffic during the holidays and a rebound in sales of big-ticket items. A manager at a shopping mall in Columbia, S.C., said that big-ticket items such as furniture, computers, and jewelry "stole the show this year." In contrast, holiday apparel sales were disappointing; a retailer in Charlotte, N.C., noted that although sales of heavy winter items made "a comeback toward the end," winter lines generally suffered because of the unseasonably warm weather in early December. Retail wages expanded at a slightly quicker pace than in our last report, in part because of an unusually tight labor market for seasonal workers.

Services: Service sector activity was flat in December. Contacts at District service businesses, including legal and accounting firms, reported that icy weather late in the month contributed to a drop in patronage and a lowering of their revenues. Inclement weather snarled highway and air traffic across much of the District and caused widespread delays and cancellations of travel plans. Employment in the services sector dropped in December although wages continued to advance briskly. Service firms reported that the prices they charge were little changed.

Manufacturing: District manufacturing activity was mixed in recent weeks. Growth in shipments tapered off in December and new orders edged lower; both measures were sharply lower at chemical and food manufacturing firms. However, despite recent layoffs at textile firms, manufacturing employment edged higher in December and there were scattered signs that the quality of applicants for manufacturing jobs was improving. A contact in Greenville, S.C., for example, told us that he was seeing "better potential employees" in his area. Some of the improvement in applicant quality may be the result of the increased availability of workers recently laid off. Several contacts noted that laid-off workers have had little difficulty finding new jobs and in many cases had received comparable pay in their new positions. On the price front, manufacturers indicated that their prices held steady, after three months of modest declines.

Looking forward, District producers remained optimistic about shipments and new orders during the next six months. They also anticipated that employment would increase and that wage levels would rise.

Finance: District loan officers reported that lending activity was strong in December. A vibrant housing market and low interest rates continued to underpin robust demand for residential mortgages. Although most contacts anticipated that mortgage lending will remain brisk in early 1999, a few cautioned that higher consumer debt levels could slow the advance. Commercial lending was characterized as "exceptionally competitive" in recent weeks; one banker noted that he could "only get business by taking it away from competitors." A Charlottesville, Va., banker reported that he was seeing more competition from community bankers who were aggressively "knocking on doors" in search of borrowers.

Real Estate: Residential real estate activity remained strong since our last report. Realtors cited continued solid job growth and business relocations to the region as primary factors sustaining activity. Builders reported slower construction activity in December, but noted that the level of building remained high for this time of year. Home prices continued to rise moderately in most areas of the District. On the cost side, only modest increases in labor and materials prices were noted. According to a Baltimore, Md., contractor, labor markets there were "tight, but workable." However, skilled tradesmen, particularly electricians, plumbers, and framers, remained in short supply.

Commercial real estate activity lost some momentum in recent weeks but nonetheless, remained at a high level. Several contacts expressed surprise that strong commercial leasing activity had continued through the holiday season which is typically a slow period. Commercial rents edged up in most areas as vacancy rates continued to fall. Looking forward, most realtors were optimistic about prospects for the commercial real estate market and for the overall economy in the coming year.

Tourism: Tourism weakened in December. A major ice storm on the East Coast late in the month caused cancellations and early departures at many coastal resorts in the District. However, colder weather during the holidays was welcome news at area ski resorts. Several resorts in Virginia and North Carolina had been forced to delay the opening of their ski seasons because of unseasonably warm weather in early December and a shortage of water reserves necessary for snowmaking. Delayed openings reduced their December revenues by about twenty percent. Nevertheless, contacts at area ski resorts remained optimistic, noting that they were now booked to capacity for most of January and February.

Temporary Employment: Strong demand for temporary retail workers during the holiday season more than offset weaker demand in other sectors last month. Outside of retail, service firms continued to hire temporary help but at a somewhat slower pace than in our last report. In manufacturing, firms cut back on hiring across the District, citing sluggish demand from abroad for their products. Despite weaker demand in some sectors, modest wage growth continued in December and many contacts believed that, within the next six months, firms would begin to increase wages substantially in order to attract workers.

Agriculture: Generally dry weather allowed District farmers to make significant headway in their fieldwork in early December. By mid- to late-December, however, winter storms brought below average temperatures and freezing rain to the region. State agricultural analysts reported no major damage to winter grains from the ice. In spite of the precipitation, farmers were still in need of rainfall to replenish soil moisture and ground water tables. In the livestock sector, colder temperatures stressed livestock and increased the amount of hay required to feed cattle. Despite increased needs for hay, no substantial shortages were anticipated.

SIXTH DISTRICT – ATLANTA

Summary: Although slower than the same period last year, contacts suggest that the Southeast began 1999 with a healthy and balanced economic expansion. Retailers report that post-Christmas day sales and heavy discounting helped to offset a slower than normal holiday shopping season. District home sales and construction increased slightly, and financial activity expanded moderately. Despite some disappointment with the number of visitors during this holiday season, industry spokespeople are optimistic that the tourism sector will accelerate in the first quarter. Manufacturing production and new orders for the region's factory sector are soft compared with a year ago, but the outlook remains generally positive. Tight labor markets continue to be a major business concern, with some signs of increasing wage pressures. Prices generally remain stable.

Consumer Spending: District retailers reported that holiday sales were up slightly from strong year-earlier levels. Bargain hunters apparently came out in force to take advantage of after-Christmas sales. Most retailers noted that the unseasonably warm weather had clearly hurt winter apparel sales, with some merchants reporting heavy discounting days before Christmas. Although sales volumes have generally fallen below expectations, most merchants report post-holiday inventories are at desired levels. The sales outlook for 1999 is more of the same, with expectations for a flat or a slightly better performance than a year earlier.

Tourism and Business Travel: Miami hoteliers were disappointed with the number of visitors during this past holiday season. Visitors reportedly traveled to the Caribbean and took cruises in larger numbers than usual. Despite a decline in Canadian tourists, tourism numbers are expected to improve in the first quarter because of the Super Bowl and the cold weather in the Northeast and Midwest. Airlines and resorts are fully booked through February. Spokesmen for major players in south Florida's cruise industry are "bullish" for 1999 because of strong bookings.

Likewise, hotel owners in south Florida are positive about 1999 and expect prices to rise slightly and occupancies to be stable. Hotel renovations continue and new hotels are being added. Growth in the gaming industry on the Gulf Coast is continuing to cause growth in tourism services such as hotels, restaurants, and retail establishments. Construction is in high gear for a new theme park in New Orleans that is expected to attract 1.4 million visitors annually.

Construction: District builders report that the pace of single-family home construction and sales in November and early December was flat-to-slightly up on a year-over-year basis. Realtors and builders continue to report balanced housing inventories. Realtors expect no change in home sales during the first quarter compared with last year's levels, and builders expect new home construction to continue to be flat in the first quarter. Commercial construction within the District remains at strong levels, and District multifamily permits continue to rebound slightly.

Manufacturing: Overall factory activity remained sluggish in December. Inventories continue high in the paper industry as the sector continues to struggle in a depressed market. Exports of manufactured goods from Miami to Latin America continue to run below those of a year ago, because of problems attributed to Brazilian markets. Uncertainty in foreign markets is causing the postponement of capital investment for some firms contacted. Reports from the apparel sector continue to be downbeat. A Tennessee apparel manufacturer that has operated for 27 years is moving operations to the Dominican Republic. The factory workweek and production is down for a producer of men's clothing.

Louisiana's energy sector is curtailing capital investment. Exploration and production budgets continue to be cut by both independent and major oil companies. More positively, many businesses report that they are advancing their investment spending plans to accelerate their Internet capabilities. District shipbuilders continue to receive large contracts and plan to add to employment rolls. Chemical and plastic plants are expanding.

Financial: Bankers throughout the Sixth District report that the financial sector expanded moderately as the year began. Overall mortgage demand and refinancing activity remain very strong. Consumer and automobile loan demand continues to grow. After some moderation last year, commercial lending has expanded at a healthy pace. While bankruptcy filings remain a concern, consumer credit quality has not deteriorated.

Wages and Prices: Tight labor markets continue to plague parts of the District. Labor shortages are reportedly a major problem for central Florida theme parks as they continue to expand. In high-tech sectors, employees continue to leave jobs for higher pay elsewhere even after being given substantial increases. Some employers note that they have greatly expanded their recruiting area in order to find skilled employees. Many contacts note that labor shortages were not a problem over the holidays, but they expect sporadic problems beginning in January, as part-time workers return to school. There were some reports of wage pressure as companies try to retain employees in a competitive environment.

Stable prices are expected to continue over the next few months, according to most contacts, with a few exceptions. Significant increases in health care costs are expected in the near term, especially for managed care providers. Softness in refined petroleum prices is expected to continue, and prices for timber are weakening.

SEVENTH DISTRICT--CHICAGO

Summary. The Seventh District economy continued its modest pace of expansion as 1998 drew to a close and 1999 began, with little change in momentum. Consumers appeared to be the major driving force behind economic growth. Retail sales were generally above merchants' plans for the holiday season, although heavy promotional activity was necessary to attain these results. New and existing home sales were, again, exceptionally strong as mortgage interest rates remained favorable. While some key manufacturing sectors continued to feel the adverse impacts of turmoil overseas, the motor vehicle industry and construction-related industries remained very robust. Overall lending activity was high, buoyed by household borrowing. Employers in the region continued to find qualified labor in short supply, and there were a few new reports of intensifying wage pressures in some entry-level positions. District farmers continued to face financial losses due to extremely low hog prices.

Consumer spending. On average, retail sales in the District were modestly above merchants' expectations for the holiday season, but many reported higher-than-expected promotional activity to attain these results. Discounters and some specialty stores fared better in December and early January than did general department stores. Unseasonably warm weather in the first few weeks of December hindered sales of winter apparel and other seasonal merchandise, forcing some retailers to steeply discount items languishing on their shelves. A raging snowstorm over the New Year's weekend, followed by an arctic blast, kept many consumers home and forced some merchants to close stores on the last big shopping weekend of the holiday season. The onset of cold weather did boost the sales of some items, such as automobile tires, batteries, snow blowers, and shovels. Winter apparel also began to move more quickly, but after stores had already marked down prices on these items. Contacts reported that appliances, home electronics, furniture, and home decorating items continued to register healthy sales gains, due in large part to strong home sales. Overall, post-holiday inventories were said to be in line with sales expectations.

Construction/real estate. Reports from realtors and construction professionals continued to point to exceptional strength in residential and nonresidential activity. Sales of both new and existing homes were reported to be at or near record levels in many areas in the District, as mortgage interest rates remained favorable. Contacts suggested that builders in many areas were experiencing double-digit gains in new home sales relative to strong results a year earlier. Construction of multifamily units was especially robust in Wisconsin, up approximately 35 percent year-to-date through November. Moreover, most contacts suggested that there were few if any signs of slowing residential construction activity in December, taking into consideration normal seasonal variations. A realtor in one of the District's largest metro areas noted that sales of existing homes set records in November and, like residential construction, displayed no signs of slowing in December. Nonresidential activity also remained brisk in the District. Infrastructure development was generally reported to be strong, although several contacts suggested that the severe winter weather in late December and early January may have slowed some projects, particularly highway projects. Commercial development also remained robust in most metro areas, particularly in the suburbs. Sites for commercial development in one large metro area were selling before any roads or sewer lines were in place, and twice as fast as projected.

Manufacturing. Although generally strong, manufacturing activity continued to be a mixed bag in the District as softness in some key industry segments persisted. Strength was reported for the motor vehicle industry and several housing/construction-related industries. Strong demand for both passenger cars and light trucks boosted national sales of light vehicles to the strongest monthly sales rate in 12 years, which led some industry analysts to increase their sales forecasts for 1999. Appliance manufacturers continued to benefit from strength in housing markets, with 1998's sales results expected to be at record levels. One industry analyst noted a "wealth effect" from strong gains in the stock market, with consumers purchasing more "high-end" appliances, increasing producers' profit margins. Also benefitting from strong home sales were wallboard producers, where one District producer recently announced a 10 percent price increase, and manufacturers of construction equipment. In contrast, sales and production of agricultural equipment remained very soft as a result of some problems in the domestic agricultural industries as well as turmoil overseas. The region's steel producers also continued to struggle, with one analyst describing the industry as "very weak" in December. Imports continued to flood the market, bloating inventories and putting intense downward pressure on steel prices. Overall, however, inventory levels in most other industries were described as being in line with sales expectations.

Banking/finance. Overall lending activity remained "vibrant" in December and the first week of January, with most contacts reporting little if any change in momentum. While noting a normal seasonal slowdown in some business segments, District bankers generally suggested strong demand for commercial and industrial loans and modest growth in loan volume. Most remained cautious in their underwriting standards for commercial real estate loans, with one banker stating that a "crimp" remained in the credit pipeline for this segment. Contacts were universal in their assessment that lending to households remained very robust. Leading the way were new mortgage originations, a direct result of the strength in home sales. Mortgage interest rates were very attractive toward the end of 1998, although they began to edge up slightly toward the end of December which, according to some bankers, curtailed the level of refinancing activity somewhat. Overall asset quality was described as good on both business and consumer loans, and profitability has benefitted from an increase in fee income resulting from the strong lending activity. A large insurance carrier headquartered in the Midwest reported that medical claims costs in auto accidents were rising. The costs to the company, however, were being offset by improving safety trends (aging of the population, reductions in drunk driving, etc.) so that overall claims costs are expected to remain stable. This contact also suggested that intense competition, particularly via the Internet, will continue a downward trend toward rate cuts for auto insurance in 1999.

Labor markets. Tightness continued to characterize the District's labor markets as 1998 drew to a close and the new year began. The average unemployment rate for the five District states leveled off toward the end of 1998, at approximately 3.6 percent. This rate is slightly higher than the very low levels attained earlier in the year, but 0.3 percentage point below year-earlier levels. With labor markets tighter in the region than for the nation as a whole, employers continued to report difficulty finding qualified workers. Employment growth in the region remained slower than in the nation in 1998, at just under 2 percent year-to-date though November. While job growth remained strong in the business and financial services sectors, contacts at staffing services firms noted that softness in the manufacturing sector persisted. Decreases in the employment components of some of the District's purchasing managers' surveys supported these assessments. There were a few new reports of the adverse affects of very tight labor markets, specifically higher turnover rates and intensifying wage pressures for some entry-level positions at smaller companies.

Agriculture. Hog prices softened in December as record-large marketings strained the capacity of the pork processing industry. In mid-December, hog prices were nearly 60 percent below year-earlier levels. Despite a modest price recovery in early January, there were reports of farmers donating hogs to charity since they were unable to recover their feed costs by selling. A USDA survey indicated that the number of market hogs in District states was up 5 percent from a year ago in December, but a decline in the number of breeding animals and farrowing intentions suggests the hog industry--both District and nationwide--is moving into a contraction phase. Beef cattle prices remained fairly steady in recent weeks and dairy farmers continued to benefit from higher-than-normal milk prices. Corn and soybean prices remained under downward pressure from large domestic supplies and the prospect of fewer hogs and lower feed demand, with soybean prices also affected by sluggish exports.

EIGHTH DISTRICT - ST. LOUIS

Summary

Economic growth in the District continues at a moderate pace, despite less-than-glowing reports from retailers. District retailers remain optimistic, however, about sales prospects in the first half of 1999. Other business contacts saw relatively healthy conditions, with some reporting an unexpected growth in sales because of unusually warm weather. Labor markets remain tight, and worker "poaching" is on the rise again in certain areas. Residential real estate markets remain strong, with a lengthy backlog in some regions. Loan demand at large District banks remains strong, especially on the business side. Despite the recent cold snap, the District's winter wheat crop appears to be in good condition.

Consumer Spending

District retailers reported that holiday sales were up on average about 2.5 percent from a year earlier. Slightly more than half of the respondents said that sales growth was below expectations. As a result, most consider their current inventories to be too high. Certain products, however, sold very well this season. Electronics, especially computers and televisions, topped many holiday shopping lists. Contacts have high expectations for the first half of 1999, with most anticipating sales to increase about 5 percent from the same period in 1998.

District car dealers reported that December sales were up on average about 6 percent from a year earlier. Most dealers noted that current inventories were not at desirable levels: some too high; many others too low. Contacts also indicated that buyers have recently substituted purchases of new cars for used cars; used car sales have slowed as a result. Overall, dealers are optimistic about 1999, anticipating sales to remain on their current track through the second quarter.

Manufacturing and Other Business Activity

District contacts continue to report overall healthy economic conditions and remain optimistic about the near-term economic outlook. Many contacts report a pickup in sales over the past few weeks, with most attributing it to the unseasonably warm weather throughout the region during the late fall. Industries that normally cut back because of winter weather, like construction and building products producers, were able to extend their productive seasons.

Labor markets remain tight in most parts of the District. In the Evansville area, for example, the Toyota plant is said to be exhausting the available workforce, and smaller businesses are unable to compete with Toyota's compensation packages. In other areas, contacts have noticed an increase in employee poaching. Despite tight labor markets, though, parts of the District, especially the Louisville and Memphis areas, are increasing their large importance as distribution centers. Many incoming firms cite the region's central location and the presence of UPS and FedEx hubs.

Shifting demand has also affected employment at some District firms. After many years of operating an intense production schedule to meet the demand for minivans, DaimlerChrysler has laid off about 500 workers at its St. Louis plant because of reduced sales. Other firms are reporting employee cutbacks because of slack Asian demand. There are also reports that weakened Asian demand is leading to a pileup of empty cargo containers at regional ports.

Real Estate and Construction

Monthly residential construction permits in almost all District metropolitan areas were down in November, although year-to-date, these areas are still on record pace. Despite the recent slowdown in permit issuance, construction continues to boom, and the backlog of contracts remains unusually high. Some parts of the District are reporting two years' worth of housing in the pipeline.

Housing sales remain strong, although the usual seasonal slowing has appeared, and price increases have moderated. Nonresidential construction in the District remains spotty.

Banking and Finance

Total loans outstanding at a sample of large District banks rose 2.8 percent in the final two months of 1998, compared with an increase of 2.6 percent in the same period a year earlier. Commercial and industrial loans jumped 4.6 percent—more than double their year-earlier growth—while real estate loans increased 2.9 percent. Consumer loans outstanding rose 1.5 percent.

Agriculture and Natural Resources

The winter wheat crop is reportedly in good-to-excellent condition in most areas. Adequate soil moisture District-wide, along with favorable growing conditions this past fall, appear to have helped considerably. Although it is too early to know for sure, the unusually cold temperatures in late December and early January may have caused some damage to the wheat crop. Cotton prices dropped about 10 percent between the end of November and early January. Although a bigger-than-expected crop has helped reduce cotton prices, contacts report that the expectation of reduced exports, perhaps because funding for the so-called Step II cotton subsidy program has run out, has had a bigger effect.

Despite the recent financial problems in much of the Farm Belt, credit availability does not appear to have been restricted for most farmers. There are some reports, though, of a small number of farmers selling tangible assets to raise needed funds. Continued low crude oil prices have led several producers to shut down a large number of low-volume stripper wells, which, accordingly, has adversely affected the demand for oil field services in a number of areas.

NINTH DISTRICT--MINNEAPOLIS

As 1999 begins, the economy of the Ninth District is strong. This is reflected in business leader sentiment, which remains optimistic overall despite a few signs of caution. Construction, which is an economic locomotive with a full head of steam barreling through one record after another, is further evidence of overall optimism. Consumer spending continues very strong, as do most manufacturing operations. Labor markets remain tight and employment high. There are few signs, if any, of higher prices. On the negative side, the primary commodity sectors including agriculture, oil, mining and paper continue under financial pressure.

Business sentiment

A statewide survey of over 400 business executives by a Minneapolis business periodical showed that 40 percent planned to add staff in 1999 and that 70 percent expected difficulty in finding employees. Fortysix percent expected sales and profits to be higher in 1999 than in 1998. Though a Minneapolis Fed district-wide poll of business leaders showed somewhat less optimism than a year earlier, a very positive outlook still predominated. Respondents generally expected increases in their own firms' investment and employment, and strong increases in sales. A somewhat more somber note was struck by a December regional survey of purchasing managers, which predicted slower growth or recession for Minnesota and the Dakotas.

Construction and real estate

"Local home-building reaches five-year high," headlined a St. Paul news article on the region's booming construction sector. Real estate and construction continue as a sector of extreme strength. November housing permits for the Minneapolis-St. Paul metro area ran about 30 percent above the average of the previous two years and other reports indicate that this momentum carried through the end of the year. Growing regional centers in Wisconsin, Montana, South Dakota and North Dakota also have strong home building.

Despite very active nonresidential building over several years, vacancy rates for Minneapolis-St. Paul office and retail space fell to their lowest levels thus far in the 1990s. Industrial vacancy rates also fell and are below most of the decade but still slightly above a low set in 1996. And a construction sector publication's annual survey of architects and engineers in Minnesota and the Dakotas revealed that most expected their design loads to increase or stay the same through 1999.

Consumer spending and tourism

"The momentum continued right through the week after Christmas," remarked one Minneapolis-based retailer in describing a widespread phenomenon. Sales before Christmas were only moderate to strong, but brisk business in the week after the holiday helped make overall holiday sales quite strong. The changing structure of retailing, including rapidly growing retail square footage and increasing catalog and internet purchases, leads many store managers to talk about difficulties, but overall spending seems quite strong. Package delivery firms reported record deliveries to homes from telephone and internet order firms. Retailers in strongly agricultural areas continue to report slow sales, especially of appliances and other durable items.

Little change is seen from late 1998 patterns in vehicle sales. Sport utility vehicles and light trucks are selling well, traditional sedans less so. Sales are strong in urban areas, but weaker in regions where agriculture predominates. Several sources noted that foreign cars were selling better than domestics. "I could have sold more if I could have gotten the product," says one Montana dealer.

Lack of snow delayed the winter tourism season in most district states, but the impact varied with location, according to tourism officials. They report improvement since snow fell in late December. One official in Michigan's Upper Peninsula reports that while the ski and snowmobile season started late, inquiries to the office were up 200 percent after snow started falling. In northern Wisconsin, traffic through tourism areas is reportedly lighter than usual. Skiing and snowmobiling started six weeks late in the Blackhills area of South Dakota, causing slack December revenues. Montana, with earlier snow than other district states, posted a good increase in December tourism compared to a year earlier.

Manufacturing

While specific firms have been hurt by reduced export sales, manufacturing output continues strong, and there was only a slight year-over-year decline in district manufacturing employment as of the end of November. Several respondents did indicate an increased sense of caution about prospects for 1999. But there are also signs of continued strength. "In Minnesota, the (manufacturing) index was up dramatically for December," said an analyst of a regional survey of purchasing managers. Referring to South Dakota, he added that "electronics manufacturing is keeping the state's growth in the positive range." One weak area is agricultural equipment, of particular importance to North Dakota.

Agriculture

"Dairy is hot and hogs are not." That statement, made at a Wisconsin ag lenders conference, accurately summarizes the salient issues in Ninth District agriculture. Dairy producers are facing the most favorable milk price to feed cost ratio in many years and dairying is strongly profitable.

Hog producers are facing the lowest prices in 30 years, with little relief expected in the near future. Lenders in areas where hog production is important express concern about the solvency of some borrowers and expect increased loan losses as a result of low hog prices.

Beef and grains, in contrast, show little change from early winter. Prices for beef, corn, soybeans and wheat all remain depressed, but not as dramatically as hogs. Strong 1998 grain yields provided some cushion against low prices, but unless prices improve many farmers expect to lose money in 1999. One major Minnesota ag lender commented, "Farmers are coming in to update their financials and arrange credit lines right now. There is not a single crop enterprise in our area that will produce enough cash flow to pay fixed costs using current prices for fall futures and five-year average yields. If we had to cut off financing to everyone who cannot project positive cash flows we would close down 80 percent of our customers."

Energy and mining

The slump in natural resource industries, particularly oil and gas drilling, continues to worsen. In the last week of 1998 the rig count for Montana was at half of year-earlier levels, that for North Dakota at a fourth. Pumping continues from existing wells, but new seismic work and leasing are at a near-standstill. Copper prices are reportedly near the shutdown price for Montana mines. Minnesota and Michigan iron mines expect to see significant drops in output in 1999 as a result of increased imports of ore and finished steel. Ironically, increased steel imports have led to increased grain and coal exports from Duluth, Minn., as freighters which have offloaded foreign steel at Lake Michigan ports search for cargo to haul back through the Seaway. Paper mills also reportedly face slack demand for many grades of their output.

Employment, wages and prices

Labor markets remain tight as a drum in the district's urban areas. Employers in booming Fargo, N.D., which reached a record 0.9 percent unemployment rate in October, and Sioux Falls, S.D., express frustration about the difficulty of finding workers. Unemployment rates remain low and largely stable in most parts of the district.

Price increases are rare at any level. Fuels and red meat prices continue as bargains for many consumers. Manufacturers report drops in prices of steel and nonferrous metals and in all petroleum-based chemicals or plastics.

TENTH DISTRICT - KANSAS CITY

Overview. The district economy grew moderately again last month, although widespread signs of easing remain. Holiday retail sales were very brisk and somewhat higher than expected. Construction activity also remained strong. But manufacturing activity in the district declined again and the energy sector weakened from an already depressed position due to another fall in energy prices. In the farm economy, recent government payments to grain producers generated some recovery in overall farm income, but district hog producers continued to have difficulties due to record-low prices. Labor markets remained very tight in most of the district, but wage pressures subsided somewhat from recent surveys, especially in the retail sector. Prices remained flat at the retail level and mixed for construction materials, while prices for steel and other manufacturing materials continued to decline.

Retail Sales. Retailers reported robust holiday sales in the Tenth District, stronger than a year ago, as consumers remained very optimistic about the state of the economy. Sales were especially strong in several large metropolitan areas, and at discount stores more than at major department stores. Sportswear and electronics sold particularly well in the Christmas season, and post-holiday sales were strong due to increased sales of coats and other winter items once cold weather arrived with a vengeance. Retail sales in coming months are expected to decline seasonally, although not as much as in past years. After months of expansion in preparation for the holiday season, stores began trimming inventories in late December, but most managers want to start increasing stock levels again within the next quarter. Automobile sales cooled slightly from a strong November, although purchases of light trucks remained steady. The slowdown pushed vehicle sales modestly below year-ago levels. Despite continued tightness in credit conditions, dealers are slightly more optimistic about the near future than they have been in the recent past.

Manufacturing. Tenth District manufacturing activity continued to slow last month, as slack foreign demand and general manufacturing weakness at the national level continued to take its toll. Slower activity resulted in plants operating at medium levels of capacity, with a few respondents even reporting low levels of capacity utilization, in clear contrast with high levels of capacity utilization six months ago. Manufacturing materials remained generally available, and lead times continued to decline. No major changes are expected on material availability in the near future. Managers have been trimming inventories slightly and were a bit more satisfied with stock levels than in the recent past, although many plan to keep trimming over the next few months.

Housing. Construction activity was robust again last month, as healthy growth in housing starts pushed activity well above year-ago levels. In addition, sales of new homes were stronger than they had been in several months, helped by the unusually warm weather. However, a seasonal slowdown in new home purchases is expected in coming months as colder weather keeps potential buyers away. Inventories of unsold homes were practically unchanged from the previous survey as faster construction activity was offset by stronger sales. Mortgage lenders reported that refinancing activity last month remained as strong as in the past few months, with total mortgage demand well above year-ago levels. Similar to developers, lenders expect somewhat weaker demand in the near future due to seasonal factors.

Banking. Bankers report that loans were stable while deposits increased last month, reducing loan-deposit ratios. Home mortgage loans increased sharply, offsetting declines in consumer loans and commercial real estate loans. On the deposit side, increases in demand deposits, NOW accounts, and money market deposit accounts outweighed a decrease in small time and savings deposits. All respondent banks left their prime lending rates unchanged last month, and most expect to hold rates steady in the near term. Almost half the banks reduced their consumer lending rates, but most expect to leave rates unchanged in the near future. Lending standards were unchanged.

Energy. District energy activity continued to slide in December as prices declined further. The rig count was unchanged from November's record low but was 34 percent below year-ago levels. The sharp declines in energy prices are likely to further slow future activity. The price of West Texas Intermediate crude oil fell 15 percent in December, to almost 40 percent below year-ago levels. When adjusted for inflation, oil is now the cheapest it has been since the Great Depression. Natural gas prices tumbled 16 percent in December, due in part to milder than normal weather throughout most of the month. However, the recent cold snap across the country is expected to push gas prices higher.

Agriculture. The district's winter wheat crop is in good condition, with adequate snow cover to protect it from the winter weather. Less wheat pasture is available than last year due to some late planting, but the existing wheat pasture is in good shape. Hog producers in the district are still facing large losses due to low market prices. Many small producers have already liquidated their herds, but remaining producers are expected to hold out for higher prices. Despite low farm prices, district farmland values and cash rents are stable. District bankers indicate that preliminary credit reviews of agricultural borrowers look fairly good. In most cases, bankers report that fewer than 5 percent of the banks' agricultural loans will not be renewed, about the same percentage as a year ago. The recent government payments helped out producers' balance sheets and likely prevented a much weaker farm income situation in the district. However, there is concern about repayment difficulties should producers have another bad year.

Wages and Prices. Labor markets remained very tight in most of the district, but wage pressures subsided somewhat from recent surveys. Information technology and construction workers continue to be the most difficult to find. Retailers again complained of a lack of entry-level and general sales workers. Despite slower activity levels, manufacturers continued to have problems finding both skilled and unskilled production workers, with welders and machinists in the highest demand. Laborers of all levels of skill and experience are still in great need for builders as well. Wage pressures, where they exist, appear greatest in the manufacturing and construction sectors. At retail establishments, many managers reported that most wage increases were given in the middle of 1998, so fewer raises to retain or attract workers were given lately. Retail prices remained flat last month and are expected to remain stable in the near future. Prices for most manufacturing materials continued to drop, especially for steel and its byproducts. In addition, more managers than in previous surveys expect prices for materials to decline further in the near future. Prices of a few construction materials, such as concrete and sheetrock, were up slightly last month, while the price of lumber edged down.

ELEVENTH DISTRICT--DALLAS

In December and January, economic activity in the Eleventh District expanded at roughly the same pace reported in the last beige book. Demand for business services remained generally strong, and retailers reported a robust finish to the holiday sales period. Overall manufacturing activity was unchanged. While there was little change in overall lending activity or credit standards, contacts said the commercial real estate lending slow down has eased, with traditional lenders regaining market share from non-traditional lenders. Construction activity continued at a brisk pace, although occupancy rates and rents softened in some areas. Crop and livestock conditions have been generally good.

Prices. Reports from most manufacturers suggest that prices are unchanged or slightly down, but the service sector continued to report rising wages and some higher fees. Warm weather and growing Iraqi sales of crude added to an existing glut of oil, keeping light sweet crude oil prices in a range from roughly $11 to $13 over the last six weeks. For most of December, warm weather held spot prices for natural gas under $2 per thousand cubic feet, but recent cold weather helped push prices up to $2. Petrochemical prices stabilized after falling through much of 1998. Downward pressure on prices for chemicals is expected to grow as new capacity comes on-line throughout the industry, and domestic manufacturers who purchase chemicals (such as pulp and paper) face increasing import competition. Plywood prices stabilized over the past 60 days, but hardwood prices have declined due to large inventories at domestic mills.

Manufacturing. Manufacturing activity expanded at roughly the same pace reported in the last beige book. Demand was up for most high-tech products, unchanged for construction-related and petrochemical products, but continued to decline for energy-related products. Demand was very strong for telecommunication hardware and software systems. Dollar sales of semiconductors declined at a decreasing rate, and one contact estimates that sales growth will turn positive at the end of the first quarter. Strong unit sales of low-cost personal computers and higher-priced business work stations are driving the improvement. Business demand is being stimulated by Year 2000 issues, according to contacts, who expect sales to remain strong through the first half of the year. Cell-phone demand is strong but has slowed due to weaker demand from Asia. Demand for pagers has declined. Producers of corrugated boxes and other paper products reported weaker demand than a year ago. Contacts say that import competition and weak domestic demand have led to an oversupply of paper. One contact suggests that e-mail has reduced the demand for copy paper. Exporters of liner board reported increasing difficulty selling to markets in Southeast Asia and Europe. Demand was unchanged for lumber used in commercial building and the end-phases of residential construction. One contact said wood imports are "easing up a little," noting that Indonesians have defaulted on some contracts to deliver lumber. Demand for cement has been "good," and contacts say the backlog of construction activity will keep sales up at least through the first part of this year. Metals producers say new orders are down. Petrochemical markets are still weak, with prices remaining stable despite a plant explosion and pipeline breakdown, that normally would have caused prices to spike. Refiners reported poor margins and a glut of product. Gulf Coast refineries have been running at capacity utilization rates close to 100 percent in recent weeks. Inventories of heating oil are "huge" according to a contact, who expects it will take months of cold weather to get them into line.

Services. Demand for business services, such as legal, accounting and consulting, continued to be strong, even though many contacts reported soft demand from clients at energy-related firms and in agricultural areas. Some companies that supply temporary workers say they still have more orders than people to fill them, including in Houston. The strongest demand for temporary workers is for systems programmers and to staff call centers and computer manufacturers. While many firms remain optimistic about the outlook, contacts remain wary, citing potential problems for the coming year, such as the Euro, the Asian economy and the stock market. Most contacts expect slower growth in activity in Houston.

Retail Sales. Cold weather and end-of-season discounting spurred a strong finish to the holiday sales period, according to retail contacts. Sales activity was particularly strong during the week following Christmas. Competition was stiff and price discounting was greater than last year, but contacts said inventories are now in good shape. Prices for apparel products are expected to fall further over the next few months. Auto sales continued to be strong, with inventories in good shape. Dealers said selling prices are roughly the same for some models and down 1 percent for others compared to a year ago, because manufacturers have lowered prices for some vehicles.

Financial Services. Contacts reported little change in overall lending activity or credit standards. Seasonal increases in delinquency rates and loan demand are expected to unwind in the first quarter. The commercial real estate lending slow down has eased, with contacts reporting that traditional lenders have regained market share from non-traditional lenders. A credit union contact said they had a record number of personal bankruptcies in November and December. Contacts reported that consumers moved money into shorter maturity instruments such as money market accounts and deposit accounts rather than CDs.

Construction and Real Estate. Construction activity continued at a brisk pace. While new speculative construction of office buildings halted a few months ago, there is still a great deal of new construction under way. Contacts expect this additional supply to be absorbed in some markets better than in others, with a small decline in occupancy rates in some areas. While most contacts predict no change in rents in coming months, a few expect as much as a 10 percent decrease in rents over the next year and have reported softening rents in the past 6 weeks, but noted that this is not yet indicative of the entire market.

Energy. Oil and gas drilling remained in a free fall, with the U.S. rig count falling from 680 to 621 rigs over the past six weeks, which brings it close to the post-World-War-II low of 596 rigs. Oil-directed drilling has fallen faster than natural gas drilling, with only 155 rigs left drilling for oil. The strongest part of the market is offshore drilling, most of it directed to natural gas. Contacts expect the global rig count to reach a post-World-War-II low in the Spring. Demand for oil services and machinery also continues to deteriorate. Producers are cutting back on capital spending, canceling projects, and leaving service companies with rapidly shrinking backlogs. Layoffs are widespread, as the industry tries to shrink to match a drilling market that has shrunk by 35-40 percent over the past year. Producers are being offered price concessions, risk sharing agreements and other incentives by service companies seeking their business.

Agriculture. While producers have not reported severe damage to crops, cold, dry winds have aggravated deficit surface moisture conditions across much of the state. Still, small grain and vegetable crops, such as spinach, cabbage and southern greens, are reported to be excellent. Livestock conditions were mostly good, and producers were taking advantage of forage availability.

TWELFTH DISTRICT—SAN FRANCISCO

Summary

Reports from Twelfth District contacts indicated a solid, but tempered, pace of economic expansion in the recent survey period. Retailers reported moderate sales growth during the holiday season, slightly below expectations. Manufacturing activity remained weak, although producers of some high-tech products noted a pick-up in demand. District agricultural conditions showed little improvement during the recent survey period, as low prices and bad weather continued to damp profits. Demand for residential and commercial real estate cooled slightly, but respondents noted that construction activity remained at high levels. Financial conditions remained strong throughout the District, although commercial borrowers faced tighter terms.

Business Sentiment

District respondents expect a solid but tempered performance from the national economy and their respective regional economies in the coming year. About 60 percent of the respondents expect U.S. GDP growth to slow to its long-run average pace, leaving the national unemployment rate near its present level. Most respondents expect inflation to remain stable, although about one-quarter anticipate an increase in inflation in coming quarters. A growing number of respondents (two-thirds) expect economic growth in their region to be at or below the national pace in coming quarters, as growth slows in regional business investment, housing starts, and consumer spending. Respondents have become more optimistic about regional trade balances; about 40 percent of District contacts expect regional trade balances to stabilize or improve slightly over the next year, compared to just 5 percent in the last survey period.

Retail Trade and Services

Respondents in most areas of the District characterized holiday retail sales as moderate and below retailers' expectations. Sales were strongest at "big box" retailers offering low-cost merchandise and at specialty stores catering to niche markets. Department store sales reportedly were flat or up slightly relative to last year, with heavy pre-Christmas discounting. Electronics, such as computers and DVD players, and home furnishings reportedly posted the strongest sales, as consumers took advantage of low prices and delayed payment options. Sales of specialty foods and fine wines reportedly were robust. Numerous contacts noted that internet shopping increased in their region. Service providers noted little change in the pace of growth in recent weeks, although tourism revenues continued to suffer from declines in East Asian visitors.

Manufacturing

Reports on District manufacturing activity remained mixed. Contacts noted that the strong dollar continues to affect both current production and future orders of a diverse set of products including industrial machinery and equipment, electronic components, wood products, processed foods, and aircraft. Lumber producers noted that strength in the domestic housing market has kept demand high, but imports of less expensive materials are beginning to temper sales growth. Demand for final-use high-tech goods, such as personal computers and medical equipment, reportedly picked up in recent months, clearing away accumulated inventories and boosting production at some firms. In general, District manufacturers reported few difficulties obtaining materials or supplies and no capacity constraints. Respondents reported that while filling vacancies remains difficult, the pressure to raise wages for existing employees has eased recently.

Agriculture and Resource-Related Industries

Respondents reported little improvement in District agricultural conditions in recent weeks. In California, a cold snap severely damaged the state's citrus crop; early estimates suggest that between 50 and 70 percent of the orange crop was damaged. In other areas of the District, low prices for cattle, hogs, wheat, feed grains, and potatoes continued to squeeze profits. Respondents reported that the price of wheat and some feed grains have declined to the point that producers cannot cover production costs. On the bright side, some contacts reported that export orders strengthened in recent weeks, particularly for meats.

Real Estate and Construction

Real estate construction and sales remained at high levels in most District states, although the pace of growth reportedly slowed. Contacts reported that home prices and rental rates have begun to level off in most markets, tempering development of new properties. Demand for commercial properties reportedly cooled in recent weeks, particularly in Northern California and the Pacific Northwest. Despite the slowdown, commercial construction activity remained strong in most areas of the District, as contractors worked on a backlog of projects acquired during the past twelve months.

Financial Institutions

Twelfth District banking conditions remained strong in recent weeks, although commercial borrowers faced tighter terms. Respondents reported that bank capital and liquidity were ample, and that competition for quality borrowers remained intense. However, concerns about credit quality, particularly among commercial borrowers, continued to restrain bank lending.