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Summary of Commentary on _____

Current Economic Conditions

by Federal Reserve District

September 1998

**SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICT**

SEPTEMBER 1998

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Summary*

The overall tenor of the District reports suggests that the economy is continuing to expand at a moderate pace, although several Districts indicated slowing in some sectors. Notably, the New York District reports that significant segments of its economy were slowing, and the Dallas District notes that economic activity decelerated in August as the manufacturing sector declined. Still, most Districts see at least modest growth in business activity from generally high levels. Despite some continuing—and in some cases increasing—softness in certain industries due to the weakened Asian economies, many Districts indicate unusually high levels of construction and good retail sales growth.

While there appear to be only marginal changes in the strength and pattern of the business expansion since the last report, several Districts indicate a sharp deterioration in both business and household expectations regarding the economy in the fourth quarter and in 1999. The Philadelphia, Atlanta, St. Louis, and San Francisco Districts all report a less buoyant economic outlook than earlier, and the Boston District sees increased uncertainty about 1999. In the Minneapolis District, “the number of sources expressing concern about the near future is striking.”

A large number of Districts continue to exhibit labor market tightness, which appears to be pushing wages up at a faster pace. On the other hand, retail prices remain

* Prepared by the Federal Reserve Bank of Cleveland based on information collected before September 8, 1998. This document summarizes comments received from businesses and other contacts outside the Federal Reserve System and is not a commentary on the views of Federal Reserve officials.

generally steady or are declining slightly in most Districts, and falling import prices have helped push industrial commodity prices lower.

Construction

Construction activity is characterized as very strong across the nation, although a few Districts report signs of slowing in some markets from high levels of activity. New and existing home sales remain high in most areas, and low inventories of unsold homes were noted in the Atlanta and Kansas City regions. Office vacancies are low or falling in the New York, Philadelphia, Atlanta, and Chicago Districts, although the St. Louis District has seen vacancy rates creep up slightly. In the Dallas region, there is concern about overbuilt industrial space.

The unusually strong growth in building activity appears to be constrained by the availability of construction workers in some areas. The Cleveland, Atlanta, and Chicago Districts note shortages of construction workers; for the San Francisco District, finding qualified construction workers posed a significant obstacle to new construction in areas where building is brisk. Rents are rising in the New York and Philadelphia regions.

Retail Sales

Retail sales remain strong in many Districts. Leading categories in recent sales growth include electronics, appliances, and furniture. Apparel items were also thought to be selling especially well. While a few Districts describe back-to-school sales as spotty, these results may have been affected by the timing of the Labor Day holiday weekend (which is not captured in this report.) In addition, auto sales were mixed by region and by

model. In some cases, a continued shortage of General Motors products was thought to be still restraining auto sales.

Retailers were mixed in their reaction to the recent fluctuations in U.S. and foreign capital markets. Boston notes some uncertainty among retailers they contacted concerning a possible fallout from financial market turmoil for 1999 and beyond, although the St. Louis District reports that retailers there have not yet observed a falloff in sales because of swings in the stock markets and are optimistic about sales prospects for the rest of the year. Similarly, contacts in the Richmond District remarked that retailers there do not expect the recent volatility in financial markets to trim their sales in the coming months.

Manufacturing

The industrial sector continues to be affected by softness in the Asian economies. Chemicals, construction materials including steel, textiles, and some types of capital goods industries have been hurt by reduced exports to Asia. Nevertheless, domestic demand continues to keep industrial activity steady at a relatively high level in many, if not most, regions.

Domestic orders growth appears to be holding nearly steady or rising slightly in many regions. In the Boston District, orders for medical equipment are said to be rising strongly. A few Districts indicate a drop in computer-related manufacturing. In the Dallas region, demand for semiconductors is said to be still weak; in the San Francisco District, sales and market conditions weakened for computer and electronics manufacturers.

Agriculture

Agricultural conditions vary greatly by region. In the Midwest, including the Cleveland, Chicago, Minneapolis, and northern St. Louis Districts, crop conditions are highly favorable. The Kansas City District expects a bumper crop of corn and soybeans, except in Oklahoma where drought damage has been severe. Bad weather conditions are thought to have reduced yields in the Dallas and San Francisco regions, and Hurricane Bonnie is reported to have caused significant crop damage in some parts of the Richmond District.

The Districts report that the combined influence of generally good harvests and weak foreign demand has exerted considerable downward pressure on agricultural commodity prices. In several cases, these influences are thought to be putting stress on farmers' balance sheets. The Dallas District indicates that low yields and low prices have led to serious financial stress for many crop producers; in the Minneapolis region, where high yields are not sufficient to offset the low crop prices, farmers reportedly face the most serious financial situation in a decade. Kansas City, however, reports that agricultural bankers in its region were not especially concerned about low crop prices.

Labor Markets and Wages

Labor shortages are still being reported in most regions, and many Districts have seen an accelerated rate of compensation growth. The workers in greatest demand are information systems personnel, including programmers. Construction and retail workers are generally thought to be in short supply. The District reports also note insufficient numbers of engineers, architects, investment managers, bus drivers, and administrative

assistants. The Boston District indicates that worker shortages are impinging on retail expansion plans. In the Cleveland District, there are concerns that farm worker shortages will make it difficult to harvest Kentucky's tobacco crop. In the Kansas City region, employers are having difficulty hiring at almost all levels.

Most, although not all, Districts have seen a pickup in compensation growth this year. Wage increases are somewhat higher in many areas, although sharply higher growth rates are seen only in fields where labor shortages have become critical, such as information systems. The Chicago District sees wage growth as stable but reports increased nonwage compensation. Minneapolis notes that strikes have become a more prominent feature of the collective bargaining environment than in recent years.

Prices

The District reports show wide agreement that price pressures remain relatively subdued. Falling import prices are said to be having a major impact on a variety of retail goods prices, such as apparel, consumer electronics, and food. However, the San Francisco region notes that prices for services such as airline travel, health care, and cable TV have started to rise significantly.

Manufacturing prices are flat, and in some industries, such as lumber, petrochemicals, steel, and a number of other commodities, prices have been falling. The only significant upward movement has occurred in the construction materials industry, with prices rising in the Cleveland, Atlanta, and Kansas City regions.

Banking

Loan demands are mixed by region and by category. In the New York and Philadelphia Districts, loan volumes have been declining recently, although seasonal factors may be at work in the former case. On the other hand, lending activity remains brisk in the Richmond, Dallas, and San Francisco regions. In the Cleveland District, demand for commercial loans continues to strengthen, but consumer borrowing has been flat. In the Kansas City region, consumer, mortgage, and agricultural loans increased, while other loan categories held steady.

Credit quality also varies by region. Delinquency rates are reported unchanged in the Cleveland District and are stable to slightly lower in the New York District. In the Richmond, Minneapolis, and San Francisco regions, credit standards have deteriorated, although a few banks in the Dallas District have tightened lending standards recently.

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FIRST DISTRICT-BOSTON

Business contacts in the First District continue to report growth. Retailers and temporary employment firms are the most upbeat, although most respondents in manufacturing and the insurance industry also say their revenues are expanding. Prices are generally level or declining. Labor markets in New England remain very tight, and base wage increases range from 2 to 6 percent. Respondents across industries express increased uncertainty about the outlook for 1999.

Retail

Most retail contacts report strong sales growth in recent months compared to a year earlier, generally above expectations. Sectors of strength were general retail, consumer electronics, home furnishings, and building materials. Men's casual wear is said to be weak, but the discount retail sector has rebounded somewhat. Looking forward, retailers expect strong sales growth to continue for the remainder of the year but they express some concern about the outlook for 1999 and beyond. Their uncertainty centers on possible fallout from turmoil in international financial markets and on domestic consumer response to recent stock market declines.

Employment is reported to be holding steady on a same-store basis. Retailers say that labor markets are very tight: Those hiring for replacement are seeing a decline in worker quality; those that are expanding find worker shortages impinging on their expansion plans; general retailers expect this winter's seasonal hiring to be very difficult. Wages are reported to be increasing at a 3 to 6 percent rate.

Most respondents report that competitive pressures are continuing to keep price inflation in check. Consumer prices are said to be either holding steady or declining slightly, while some purchase prices -- for lumber, apparel, and consumer appliances -- are reported to be declining significantly. Most contacts say profit margins are holding steady.

Manufacturing

Three-quarters of the First District manufacturers contacted indicate that recent business is up from a year ago. Most of these respondents cite percentage gains in the single digits, although orders for medical equipment are said to be rising strongly. Contacts report that business with General Motors has increased since the end of the strike but not as much as expected. Some equipment manufacturers cite other areas of recent softness, including computer circuitry and appliances. Contacts indicate that overall exports have been "okay" at best. Sales to Asia continue to fall off, and one manufacturer reports that its Russian business has "come to a stop." Overall, one-half of the manufacturers contacted expect some slippage in economic growth. Most respondents holding this view cite either foreign developments or the possibility of deteriorating consumer confidence stemming from declines in stock prices.

Almost all manufacturers indicate that both their materials costs and their selling prices are stable or falling. The few increases in selling prices are in the range of 2 to 4 percent.

Most contacts are making only modest changes in employment levels, but over half indicate difficulties filling some positions. These occupations include information technology, engineering, finance, equipment servicing, sales, and toolmaking. Overall pay is said to be rising 2 to 5 percent, but some contacts mention double-digit increases for certain categories. One-third of the manufacturers indicate that overall pay raises are now higher than before or will be higher in 1999 in order to stem turnover. Almost one-half of the respondents intend to reduce inventories. However, most plan sizable investments in fixed capital, primarily to increase operating efficiency or to develop capacity for new products.

Temporary Employment Firms

First District temporary employment firms continue to expand. Contacts report revenue growth between 10 and 20 percent over a year earlier. Markets for temporary and contract workers remain extremely tight across all industries and locations in the First District.

Wages also continue to increase but the increases are said to be slowing down for less skilled occupations. Respondents are no longer feeling squeezed by their clients' resistance to price increases; one contact even reported that "pricing is the best it's been in a year."

Outlooks for the next twelve months are mixed. Some respondents are optimistic, predicting continued solid performance. Others are more cautious, anticipating a softening of the regional economy toward the beginning of next year.

Nonbank Financial Services

Respondents at insurance companies report revenues in the second quarter of 1998 ranging from flat to 25 percent increases. Mutual funds and variable annuities were responsible for much of the growth in sales. Employment changes range from down 5 percent to up 4 percent. Most respondents note continued shortages of information systems personnel. In response, they are relying more on outside contractors, raising base salaries, and increasing the amounts and types of bonuses. A number of respondents also note a scarcity of accounting and investment management professionals.

SECOND DISTRICT--NEW YORK

Significant segments of the Second District's economy have shown signs of slowing since the last report, with the notable exception of construction and real estate. Retail sales were on or somewhat below plan in August, with some weakness attributed to lean inventories; both selling prices and merchandise costs were steady to down slightly and most retailers do not report increased wage pressures. Following a robust second quarter, District housing markets strengthened further in July, particularly in the multi-family sector in and around New York City; anecdotally, any effects of the recent stock market slump on the metropolitan area's housing market appear to be limited, as yet. Manhattan office vacancy rates resumed their decline in July, while rents continued to rise rapidly.

Despite the end of the GM strike, regional surveys of purchasing managers suggest some underlying weakness in regional manufacturing activity in August, along with flat to declining commodity prices. Finally, local banks report that loan demand growth paused while delinquency rates leveled off after falling steadily through most of 1998.

Consumer Spending

Major retailers generally report that sales in the region were on or slightly below plan in August, with year-over-year comparable-store sales ranging from a 2 percent decline to a 7 percent rise. Some of the weakness in sales was attributed to unusually low inventories of clearance merchandise and unseasonably warm weather—also, a late Labor Day is expected to pull some sales from August into September, though this was anticipated in sales plans. Apparel sales are still said to be fairly brisk, but a few contacts note that demand for home goods, while still brisk, has tapered off. All contacts say that inventories were at very favorable levels at the end of August. Two large retailers note that shipping bottlenecks from West coast ports prompted them to take on holiday-season imports earlier than usual, thus temporarily boosting inventories. However, most contacts report no shipping troubles.

Retail selling prices and merchandise costs were steady to lower; most respondents describe the current pricing environment as "very competitive." A number of retailers anticipate sizable price reductions in early 1999, reflecting falling import prices. While most retailers report no increase in wage pressures, all note difficulties in finding enough staff and expect this problem to worsen as the holiday season approaches.

Construction & Real Estate

Housing markets across the District continue to gain momentum. New York State realtors report that sales of existing single-family homes strengthened further in July. Compared with a year earlier, unit sales surged 21 percent while selling prices rose 10 percent. While the strongest gains in both sales and prices were still concentrated in the New York City area, trends in upstate New York have improved considerably. Similarly, homebuilders in northern New Jersey report that the market for single-family homes remained strong in July and August, following a brisk second quarter, though some softening was reported in the high-end of the market. Permits to build single-family homes in New York and New Jersey continued to trend up in July and, year-to-date, are running nearly 10 percent ahead of last year; 1998 is on track to register the highest level of single-family permits since 1989.

The multi-family sector appears to be even stronger, due to a dearth of construction in recent years. A leading Manhattan real estate firm reports that co-op and condo prices rose briskly in July and were up more than 30 percent from a year earlier. While the impact of the recent downturn in the stock market remains to be seen, the same firm notes that some prospective buyers pulled out of deals following the late-August stock market drop. Separately, northern New Jersey property developers note extraordinary strength in demand for new luxury rental units and expect a sustained pickup in multi-family construction over the next year. So far this year, however, multi-family building permits in both downstate New York and northern New Jersey have been running below 1997 levels.

Manhattan's office vacancy rates resumed a steep downward trend in July, with Midtown's rate falling from 8.7 to 8.0 percent and Downtown's tumbling from 13.9 to 12.3 percent. Rents continued to surge in July—for Class A properties, they are up roughly 20 percent over the past 12 months.

Other Business Activity

Local purchasing managers surveys indicate some fundamental weakening in the District's manufacturing sector in August. Buffalo purchasing managers report a surprisingly feeble rebound in the local manufacturing sector in August, following a sharp drop in July due to the GM strike. While new orders expanded at roughly the same pace as in the second quarter, production activity rose only marginally, and employment continued to decline. Commodity prices remained steady. New York purchasing managers report some slippage in manufacturing business conditions in August, along with a moderation in hiring intentions. Prices paid by local manufacturers fell sharply in August, while prices paid in other sectors were essentially flat. However, prices for contracted services continued to rise—especially for computer consultants, engineers, and architects.

Financial Developments

According to a survey of senior loan officers at small and medium sized banks in the second district, the overall demand for loans decreased over the past two months. Several bankers, however, note that much of this slowing was seasonal. Refinancing activity also fell over the past two months. A smaller proportion of bankers than in the past few surveys report increased willingness to lend. However, credit standards remained virtually unchanged in all categories of loans.

Interest rates on all categories of loans declined over the last two months. Residential loan rates were lowered most frequently, with 50 percent of banks reporting lower rates and only 4 percent reporting higher rates. Average deposit interest rates also decreased, on balance. Delinquency rates, after declining steadily in 1998, were stable to slightly lower for all types of loans in August.

THIRD DISTRICT - PHILADELPHIA

Overall business conditions in the Third District improved slightly in August, although there was evidence of slower activity in some sectors. Manufacturers reported a better rate of shipments and orders compared to July. Retailers saw a sales increase for back-to-school shopping, although the year-over-year increase was slight. Auto sales were steady. Bank loan volume has been declining. Suburban commercial real estate markets remained fairly tight, although the vacancy rate has increased in central Philadelphia. Home sales had been steady, but real estate agents noted a drop in inquiries and purchases in the last week in August.

Expectations for future conditions have become more modest and uncertain than they were earlier in the year. Manufacturers expect growth in the next six months to be slower than it has been so far this year. Retailers say the small boost from back-to-school sales may portend slower growth ahead. Bankers expect some pickup in consumer lending but do not anticipate an increase in business lending. Real estate agents believe some prospective home buyers may delay purchases until financial markets return to stability.

MANUFACTURING

Manufacturing activity in the Third District improved somewhat in August compared to July. More than one-third of the firms contacted reported increases in shipments and new orders, while less than one-fourth reported decreases. On balance, order backlogs were unchanged and inventories fell. Producers of chemicals and construction materials and equipment noted further decreases in demand for their products from Asia; reports from other industrial sectors were

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positive. Overall, industrial companies added workers in August, and they plan to hire more in the next six months. Firms have also boosted capital spending plans.

On net, industrial prices in the District continued to move down in August. Nearly eight in ten firms surveyed reported steady prices; however, among those noting changes, more firms reported declines than increases in both input costs and the prices of their products.

Despite the improvement in August, manufacturers anticipate slightly slower growth in business during the next six months. They expect only modest gains in orders, but they foresee some firming of prices. On balance, they plan to continue adding to payrolls.

RETAIL

Retailers reported the usual back-to-school pickup in late August and early September, but most said the year-over-year gain was slight. Sales varied by type of merchandise. A high sales rate for appliances and home goods appeared to be continuing, according to some merchants, who noted large increases from a year ago. Sales of other merchandise did not appear to be as strong, and some retailers think growth could be slowing. In general, discount stores were posting better sales than specialty and department stores.

Auto sales in the District ran at a steady pace during August, according to dealers, but below the rate set in spring and early summer. Manufacturers' incentives have been increased recently, bolstering sales for some dealers. General Motors outlets, however, were still short of inventory, and their sales remained well below the pre-strike rate.

FINANCE

Bank loan officers contacted in early September generally reported that loan volumes outstanding at their banks have been declining in recent weeks. Demand for consumer credit has

dropped, but bankers expect growth in this category of lending to resume later in the fall.

Business lending has also eased at the banks contacted for this report. One factor cited for the decrease was relatively strong cash levels at many firms, which allowed them to meet their financing requirements with internal funds. Bankers do not foresee a significant pickup in business loan demand, and they expect competition for commercial loans to remain very keen.

REAL ESTATE AND CONSTRUCTION

Home builders and real estate agents said sales of both new and existing homes were level and at a good rate in July and most of August. Some noted a drop in inquiries and sales at the end of August continuing into September, especially for homes in the upper price ranges. They believe turmoil in financial markets has made prospective buyers more cautious. Conversely, several builders and agents noted that interest by first-time home buyers remained high, and they attribute this to low mortgage interest rates and strong employment in the region. Real estate agents said home price increases have been slight and buyers are reluctant to bid prices higher now because they do not expect much price appreciation in the future.

Commercial real estate markets remained strong in most parts of the District, according to recent surveys by brokers. Office vacancy rates have fallen and rents have risen in most suburban markets, but vacancies have increased in Philadelphia's central business district. The increase in rents is expected to slow during the rest of the year as speculative and build-to-suit construction catches up to the demand for more space. The vacancy rate for industrial space has been falling in the suburbs but rising in Philadelphia. Contacts in some parts of the District report that it is difficult to obtain local government approval for industrial construction, and this is limiting the supply of new space.

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FOURTH DISTRICT - CLEVELAND

General Business Conditions

Business activity in the District remains strong, and prices are generally flat or falling across a broad range of goods. Still, wage growth appears to have increased from earlier in the year.

Temporary employment agencies report increased wages and an uptick in labor demand following a short leveling-off period. Office workers, customer service representatives, and general laborers are in high demand. Many firms, especially in the southern part of the District, report wage hikes by as much as 20% from a year ago, with much of the increase coming in the past few months. Even with the higher wages, agencies are having a difficult time filling positions. Some union sources indicated a pickup in wage growth to about 4%; others see wages growing at their longer-term trend rate of about 3%.

Agriculture

Although harvests are expected to be good or better for a variety of the District's crops, a falloff in crop exports and above-average yields elsewhere have put sharp downward pressure on many agricultural prices. A notable exception to this pattern is the District's dairy products, for which prices have firmed.

District corn production is expected to be slightly better than last year's high levels, despite a drop in acreage planted. Corn conditions are also comparable to those of 1997, with a relatively high proportion of the crop rated good-to-excellent. Similar yields and conditions are reported for the District's soybean crop.

Dry late-summer weather has favored Kentucky's tobacco crop, 56% of which is now rated in good-to-excellent condition, compared to 38% at this time last year.

Farmers are also anticipating above average tobacco yields, although there is growing concern about finding adequate labor to cut and house this year's crop.

Construction

The overwhelming majority of respondents indicated that construction in the recent period has been brisk compared to this time even last year. There is a hint, however, that activity may be starting to slow. Moreover, several builders expressed concern that the recent drop in equities could undermine consumer and business confidence, thereby slowing the expansion of construction activity.

The costs of construction projects show some upward pressure. In Central Ohio, land prices are reported to have risen somewhat, while other locations indicate a slight upward tilt to wage growth. Indeed, tight labor markets continue to be a concern in this industry. Some reports indicated that a growing number of contractors from neighboring states have been bidding on jobs in Ohio and bringing in out-of-state crews with increasing regularity.

Industrial Activity

Manufacturing activity in the District remains good overall, although the restraining effects of the Asian crisis are still being felt in some industries. Export markets have continued to dwindle. In the steel industry, a high level of imports, combined with newly added domestic production capacity, has softened prices.

Chemical producers report that, although sales are up slightly from earlier in the year, they were still lower than expected, perhaps due to increased competition from foreign producers. Chemical prices remain flat but some firms have been having a little more difficulty in finding skilled workers.

The transportation industry is still growing, although somewhat less strongly than earlier in the year. Prices have been stable and there has been no more than the usual difficulty in hiring additional workers. District railroads are reporting a good recovery after the GM strike.

Consumer Spending

Although sales tapered off slightly at the end of August, the retail sector continues to show strength. National retailers indicate that spending in the Fourth District has exceeded U.S. averages. Some of the District's discount stores have reported double-digit increases in sales year-over-year, while other retailers report mid-to-high single-digit sales growth. Among the various retail categories, women's apparel, jewelry, housewares, and furniture have shown substantially improved sales growth. Sales of women's accessories, fragrances, and men's apparel, however, have been sluggish. Retail contacts are generally optimistic about the important fourth-quarter shopping period, with projected increases ranging from 3% to 15% over last year.

Retail inventories are said to be "on plan" with sales projections, and there is no clear indication of price alterations. Owing to sales strength and anticipation of the upcoming holiday season, retail outlets continue to add staff. Many are having trouble

finding workers, however, and this may have begun to put upward pressure on wages in some cases.

Auto dealers reported strong sales through August. An exception to this rule is the GM dealers; The UAW strike left them with a shortage of vehicles. In general, the strong August sales caught dealers a bit off-guard which resulted in thin inventories.

Banking and Finance

Demand for commercial loans continues to strengthen, with only a few banks reporting otherwise. Consumer borrowing has been flat, and a few banks report a slight softening in this credit category. While mortgage refinancing activity is still strong overall, several banks have reported a decrease over the past two months. Consumer loan delinquencies are generally steady, and a few banks have even noted improvements. Commercial loan delinquencies remain unchanged at low levels.

Competition for borrowers is still fierce, and the spread between borrowing and lending remains narrow. One source indicated that deposit inflows have improved a bit as investors move funds out of equity markets.

FIFTH DISTRICT – RICHMOND

Overview: Fifth District economic growth moderated in the weeks since our last report. Weak auto sales and light customer traffic held back retail expansion, and service sector sales were off their earlier pace. Manufacturing growth eased in recent weeks, slowed in part by increased competition from Asian producers. Real estate and banking activity remained strong, but there were signs that growth may be leveling off. Workers remained in short supply across the District. Wage pressures picked up in the services sector but eased somewhat in retail and manufacturing. Prices of goods and services advanced at modest rates. In agriculture, Hurricane Bonnie brought much needed rainfall to farmland in some areas, but also caused widespread damage to crops in coastal areas of Virginia and the Carolinas.

Retail: Retail sales growth moderated in recent weeks as sales of big-ticket items fell and shopper traffic declined. Sales of most makes of automobiles declined sharply and General Motors dealers reported lower-than-normal inventories in the aftermath of the UAW strike. Retail employment changed little in August, and despite an easing of wage pressures, reports of higher wages to retain workers remained common. Looking forward, retailers did not expect the recent volatility in financial markets to trim their sales in coming months; in contrast, they remained optimistic regarding a pickup in activity.

Services: Revenues at service-producing firms declined modestly in August. One contact who operates a language school in Virginia reported that “the demand from foreigners just hasn't been as strong as in the past.” Service-sector employment edged lower in recent weeks although wages grew at a faster clip. Price growth, however, moderated somewhat in August. The outlook for the next six months remained upbeat suggesting that service providers may view their recent sales dip as temporary.

Manufacturing: District manufacturing growth stalled in August following an unusually strong July. Although new orders grew slightly faster, shipments were flat. Producers of textiles and apparel, industrial machinery, and chemicals reported disappointing sales growth. Several textile manufacturers attributed softer sales to effects

of the Asian financial crisis, and a producer of engineered plastic components for industrial machinery reported that “things are really dead now.” Despite the return of General Motors workers, manufacturing employment in the District edged lower and wage growth moderated somewhat. Looking ahead, most contacts were less optimistic about business conditions in coming months, and they anticipated a sharp reduction in their capital expenditures.

Finance: Lending activity remained brisk throughout the District and competition among banks for commercial loans intensified in August. A Charleston, S.C., banker noted that an increasing number of banks were pursuing loan accounts in his area and remarked that “you can’t walk around the block without bumping into these [new] guys.” There were also more reports of bankers sweetening commercial loan terms in order to attract business and to “keep people from stealing current customers.” A few residential mortgage lenders reported that loan demand tapered off in August, but they attributed the declines largely to the summer vacation season.

Real Estate: Residential real estate activity remained strong in recent weeks but the rate of expansion softened. Contacts reported that the Washington, D.C., Raleigh, N.C., and Charleston, S.C., markets remained particularly strong, while the Charlotte, N.C., market was said to be showing signs of slowing. Builders reported that sales of higher-priced homes and of vacation or second homes picked up. Most realtors told us that recent stock market fluctuations had not affected real estate activity in their areas so far; several, however, expressed concerns that continued declines could rattle consumer confidence.

Commercial real estate activity continued at a high level, although little growth was reported outside of West Virginia and South Carolina. Despite the overall sluggishness in the sector, the construction and leasing of retail properties continued to be more active in most areas. Several contacts, however, were cautious about future activity. A South Carolina realtor noted that the pace of acquisitions had slowed in his area and that institutional buyers were “backing away” from deals as their sources of money dried up. Similarly, a contact in the Washington, D.C., area said that some buyers were “folding their tents” and that some capital was “fleeing” the real estate market in recent weeks.

Tourism: Tourist activity was little changed in August despite the disruptions caused by two hurricanes. Many coastal hotels in the Carolinas closed for most of the last week in August in advance of Hurricane Bonnie. One contact on North Carolina's Outer Banks reported that business prior to the hurricanes had been much stronger than anticipated and that it could be one of his best years ever. In contrast, a hotelier in Myrtle Beach, S.C., said that business was "way off" because of Hurricane Bonnie, and that tourists had been scared away by the media build-up surrounding Hurricane Danielle. Looking ahead to coming months, District contacts expected tourist activity to match last fall's pace.

Temporary Employment: The demand for temporary workers from non-manufacturing firms remained strong in recent weeks. Programmers and administrative assistants with computer skills continued to be in critically short supply. In the manufacturing sector, however, increased uncertainty surrounding sales prospects reduced some producers' demand for contingent employees. Contacts reported that wages generally remained stable, but many expected sharp wage increases to be a "sure thing" during the next six months if labor markets tighten further.

Agriculture: Although coastal counties of North Carolina and Virginia received significant amounts of rainfall from Hurricane Bonnie, topsoil moisture in most areas of the District continued to be short to very short. Agricultural analysts reported that crop damage from the hurricane was "severe" in southeastern Virginia and resulted in 20 to 30 percent crop losses in coastal areas of South Carolina. Early estimates indicate that over 350,000 acres of crops sustained some level of damage in North Carolina.

SIXTH DISTRICT - ATLANTA

Summary: Most Sixth District contacts report a modest expansion of overall economic activity in recent weeks and a weaker outlook than in the July report. Retail sales improved slightly, but single-family home sales were somewhat weaker, and multifamily home construction has begun to moderate. Recent manufacturing activity has weakened slightly. The tourism sector remains robust, and loan demand continues to expand moderately. Employers are increasing benefits to retain workers in tight labor markets, but intense competition and long-term contracts are expected to keep prices stable.

Consumer Spending: District sales improved overall in August after a mixed July, as most contacts reported that sales were up slightly compared with a year ago. Recent back-to-school results, however, have been spotty. Some merchants said that the early start of school had shifted purchases earlier than usual and will likely dampen sales figures somewhat in the short term. Inventories are balanced and retailers expect that third quarter sales will be flat or slightly up compared with last year.

Construction: Reports from real estate contacts indicate that single-family home sales during July were above year-ago levels but were somewhat weaker in August. Most District builders reported that new home construction was up slightly in July and August on a year-over-year basis, while new home sales were flat to slightly up. Many Realtors report that listing inventories are too low in their area, although they believe new home construction is adequate. Looking forward, builders expect construction activity to remain at high levels through the end of the year. Real estate agents expect third quarter home sales will be strong but fourth quarter sales will weaken.

Multifamily construction has begun to moderate in many District markets. Commercial real estate markets remain generally healthy throughout the region; construction levels are considered strong, and vacancy rates remain at historically low levels.

Manufacturing: Factory activity slowed slightly, according to the latest reports, with weakness in some sectors supported by strength in others. Most contacts are not as optimistic as in the last report about future prospects and do not plan to add significantly to job rolls over the next few months. The resolution of the *General Motors* strike has District assembly plants working overtime to make up for production losses. The region's chemical industry is benefiting from the strong U.S. economy and low oil and natural gas prices, as evidenced by new plant announcements and expansions. Despite some weakness in oil prices that has slowed onshore drilling, demand for deepwater offshore drilling rigs is stimulating capital investment activity. Less positively, weakness persists for District apparel producers. A large regional apparel company plans to cut as many as 4,000 jobs over the next three years, as the company shifts production to other countries. A decline in Asian orders, excess industry capacity, and weaker foreign currencies have forced the temporary closure of a large pulp operation.

Tourism and Business Travel: Central Florida theme parks continue to report strong tourist activity. Over 2,200 new hotel-motel rooms have been added to the Orlando area over the last year to accommodate the increasing number of visitors. A new trade-expo facility under construction near Orlando and expansion of existing facilities in Orlando reportedly will make the area the world's largest convention center within a few years. There is concern from tourism officials that the weak Canadian dollar may cut back visits to south Florida from Canadians, but a new marketing campaign targeted at Latin America is expected to help lift the number of south

Florida tourists from those countries. Airline passenger activity is up by over 6 percent in Atlanta from a year ago with a double-digit increase in international passengers.

Financial: Banking contacts throughout the Sixth District report that loan demand continues to expand at a moderate rate. Consumer loan demand remained healthy, while the commercial and mortgage markets continue to experience strong demand. Consumer loan quality has not deteriorated despite the high levels of bankruptcies, and bankers say they are not tightening standards. Competition continues to be heavy for loans and deposits.

Wages and Prices: Tight labor markets continue to pressure District employers. Companies are boosting benefits to recruit and retain workers. One manufacturer notes that they have recently increased the base pay rate for all information technology people by 15 to 20 percent to keep from losing them. A large residential builder says that a shortage of skilled trade workers is causing significant delays and price increases. In Louisiana, labor shortages at local shipyards are forcing some yards to forego business. About 5,000 to 7,000 welders and other skilled laborers are reportedly needed for the state's shipyards.

Competition and long-term contracts are expected to stabilize prices for the foreseeable future for the majority of firms contacted. Slumping oil prices are hurting smaller energy extraction companies in Louisiana, and weak prices are causing pulp and paper producers in the region to cut back their operations. However, residential builders note increasing materials prices.

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SEVENTH DISTRICT--CHICAGO

Summary. The Seventh District economy continued to expand at a modest pace in August and early September, but reports became more mixed than earlier this year. Reports on consumer spending trends varied as the later Labor Day holiday may have delayed sales of some items. Overall construction activity remained robust, with exceptional strength in housing and highway development leading the way. Manufacturing activity became more mixed, partly as a result of softening markets abroad. Lending activity remained brisk, although business demand may have softened somewhat. The District's labor markets quickly shook off the ill effects of auto industry strikes and remained much tighter than the nation as a whole. Crop conditions in the Seventh District were steady and generally favorable heading into September, but prices for most agricultural products continued to lag year-earlier levels. Most contacts stated that it was too early to assess any impacts from the recent stock market volatility and economic turmoil in Russia.

Consumer spending. Contacts in the retail trades reported mixed results for August and early September. Sales at discount stores appeared to have been stronger than department stores. A contact at one national discounter suggested that the recent retrenchment in the stock market may have actually helped their sales. Department stores reported that apparel and back-to-school items were selling slower in August than in previous years as a result of the later Labor Day holiday. Most contacts expected sales to pick up after the holiday weekend, and inventories and promotional activities were in line with most merchants' expectations. Sales of home items (electronics, appliances, furniture, draperies, etc.) remained very strong. Providers of home services such as lawn care, pest control, and cleaning services also noted strong sales. Regional auto sales were mixed. One large manufacturer reported that light vehicle sales in August were up nearly 40 percent in the Midwest region (compared to 10 percent for the nation as a whole) and carryover of 1998 models was lower than it's ever been. However, a District auto group noted that traffic through showrooms was slow and sales were down across most makes and models. A few contacts indicated that sales of GM products were hampered by a large carryover of post-strike assembled 1998 models and slow delivery of 1999 models.

Housing/construction. Activity in housing markets continued to exceed most contacts' expectations and overall construction activity remained very robust. Sales of existing homes remained strong, with one large District realtor reporting that August sales results were in line with a record sales pace attained earlier in the summer. This contact suggested that inventory was turning over so quickly that the company had to increase its promotional activities to attract new listings. A recently released report indicated that home prices in the Midwest were appreciating faster than

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any other region in the country. New home sales were becoming more mixed. Many builders indicated that the market for new homes was “steady as she goes” while a few indicated that activity had slowed somewhat from very high levels. One contact noted that a builder of upper-end specialty homes was booked completely through 1999. On the commercial side, announcements of new office development were becoming more frequent in some metro areas as vacancy rates remained very low. At least one contact, however, cautioned that some of these announcements are aimed at gauging large tenants’ interest in the project; if potential tenants show no interest, the project never gets off the ground. Although activity remained brisk, development of retail and light industrial space has slowed in some areas. Analysts suggest that this softening may be a brief period of absorption following strong development earlier in the year.

Manufacturing. Production levels remained high in the District’s manufacturing sector, although growth had slowed noticeably in some industries. Reports from producers of heavy trucks and construction equipment indicated the most strength. One analyst in the heavy truck industry noted that lead times continued to build and the industry would probably break records in 1998 for both production and sales of heavy trucks. Output of construction equipment remained high, benefitting from exceptional housing activity and highway development. Two major manufacturers of construction and other heavy equipment, however, noted a slowdown in orders and one has already cut production schedules for the second half of the year. Inventories of agricultural equipment were reported to be building as producers continued to struggle under the combined weight of the economic turmoil in Asia and declining food commodity prices. Growth in sales of light vehicles nationwide has slowed from the first half’s torrid pace and most contacts indicated that inventories were in very good shape heading into the new model year. Steel consumption was up approximately 3 percent year-to-date through the end of July, with exceptional strength in the domestic market and increased shipments to western Europe outweighing decreased exports to Asia. The long anticipated surge of imported steel, however, appeared to have finally arrived in the late summer months and analysts expect record levels by the end of the year. Pricing generally remained flat across manufacturing segments though some very modest increases were being pushed through in select industries.

Banking/finance. Like manufacturing, lending activity remained high, although loan growth had slowed. Consumer lending remained very strong, largely as a consequence of strength in housing markets and low interest rates. New mortgage originations, which normally drop off seasonally toward the end of summer, remained relatively steady. At the same time, declining interest rates continued to bolster refinancing demand. On the business side, there was a discernible softening in demand, “not a contraction, just a slowing of growth,” according to one banker.

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Demand for acquisition loans remained firm though a major lender noted that growth, while still in the double-digits, was roughly half that experienced in 1997. Lending for capital and automation investment waned as concerns over softening overseas markets made some borrowers more cautious. Commercial real estate lending activity remained very brisk and was reported to be picking up, with competition among lenders very intense. This continued to raise concerns among some contacts over the asset quality of these loans. Profitability, however, remained very "solid" according to most bankers.

Labor markets. Labor markets in the Seventh District remained much tighter than the nation as a whole, despite the disruptions caused by the auto industry strikes. Unemployment rates in the region ticked up in June and July, and claims for unemployment insurance benefits soared as a result of the strikes. Once a settlement was reached, however, initial unemployment claims dropped and by late August were back to the very low levels that the region has experienced over the last three years. Information Technology (IT) and construction workers remained the most popular response to the question, "What occupations are in short supply?" General wage pressures again remained subdued, with employers using more non-wage incentives (bonuses, casual dress, flexible hours, etc.) to attract and retain quality workers. The exceptions were in occupations where severe shortages persisted, such as IT workers. One large corporation had recently restructured the compensation packages for employees working on their "Y2K" issues, a move intended to lock in their services through the year 2000. Several locales were reporting increased wage pressures in some of the higher-skilled clerical occupations.

Agriculture. Crop conditions in the Seventh District were steady and generally favorable heading into September. A recently-released yield survey suggested the potential for a large corn crop this fall as well as a record-large soybean harvest. However, crop conditions in Michigan lagged the other District states due to a lack of rainfall. Corn and soybean prices continued to decline in August, with corn prices reaching their lowest level in ten years. In addition, prices for hogs and beef cattle continued to run well below year-earlier levels. In contrast, dairy farmers benefitted from lower feed costs and milk prices that were, on average, 20 percent higher than in August 1997. Our survey of agricultural bankers indicated that overall farmland values were unchanged during the second quarter, and most bankers expected farmland values to remain stable in the third quarter. The bankers also noted that the pace of loan repayments was slower than a year ago and anticipated a year-over-year decline in requests for loans to purchase farm machinery and equipment this fall.

EIGHTH DISTRICT - ST. LOUIS

Summary

District economic conditions remain quite healthy. Although the pace of growth does not appear to have slowed much, particularly in view of recent financial market unrest, there is some expectation of moderating labor market demand over the last three months of the year. Retailers report that summer sales either met or exceeded expectations and are upbeat about sales prospects for the rest of the year. Auto sales have been up moderately at non-GM dealers. Tight labor markets still reign in most of the District, and most contacts report continued strong demand for their products. Sales of new and existing homes have held up well, and new construction remains strong overall. Compared with the average of three months earlier, the most recent Manpower survey indicates some tempering of the demand for labor in the fourth quarter. Loan demand at several large District banks appears to have slowed during the past two months.

Consumer Spending

District retailers report that sales in July and August were up 4 percent on average over a year earlier, which met or exceeded their expectations. Electronics, apparel, and lawn and garden items have been in high demand; fine jewelry has not. Current inventories are smaller than earlier. Contacts have not yet observed a falloff in sales because of the swings in the stock market and are optimistic about sales prospects for the rest of the year.

The District's GM dealers contacted saw sales fall by an average of 25 percent in July and August from a year earlier because of lack of product. Other dealers report that sales were flat to up moderately. Despite the GM strike and weak Asian currencies, contacts believe that, for the most part, brand loyalty kept many customers from leaving GM. GM dealers do not anticipate wide usage of rebates or other incentive programs any time soon, mostly because of reduced inventories,

although many other dealers do. Overall, contacts are cautiously optimistic about sales prospects for the rest of the year.

Manufacturing and Other Business Activity

Despite the wild ride stock markets have taken over the past few weeks, most contacts report that they have not seen a major change in economic fundamentals, at least not yet. Labor markets remain tight in most parts of the District, with the demand for skilled labor, in particular, extremely high. Some contacts have seen moderate rises in compensation packages recently. Sales remain relatively robust, especially in industries providing construction-related items, like building materials and household appliances. Reports of business expansions have not tapered off. Contacts in the electronics and paperboard industries report growth in productive capacity and employment because of increasing demand. A report about the District's furniture industry cited recent plant openings, with additional capacity in the pipeline. Ebbing domestic and foreign tobacco demand, however, has led to additional layoffs on top of the workforce reductions already occurring through early retirement and attrition.

Real Estate and Construction

Sales of new and existing homes continue to boom throughout the District, keeping turnaround time short and prices up. Monthly permits for new residential construction, however, slowed in July in all but three of the District's 12 metropolitan areas. Compared with a year earlier, though, year-to-date permits are up in nine metro areas and are on pace for a record year, especially in Little Rock, Louisville and Memphis. Commercial construction has shown early signs of slowing in some areas as demand slackens slightly and vacancy rates creep up modestly. Construction of new apartment complexes, though, remains strong, particularly in the Little Rock and Memphis areas.

Labor Outlook

According to the latest Manpower quarterly survey of businesses in the four major cities

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of the Eighth District, the growth in demand for labor is expected to taper off some later this year. On average, net business hiring (the percentage of respondents intending to add to staff levels, less the percentage intending to subtract from current staff levels) is expected to be down by about 10 percentage points during the fourth quarter compared with the same period three months ago. The greatest drop is expected to be in St. Louis and Memphis. Labor market conditions are expected to slacken only modestly in Louisville, with roughly no change expected in Little Rock.

Compared with the same survey a year earlier, net business hiring on average is expected to be down even more, about 13 percentage points, with firms in all four cities indicating less willingness to add staff. On a positive note, manufacturing firms seem increasingly willing to add employees, which is somewhat of a break from the recent developments.

Banking and Finance

Total loans on the books at a sample of large District banks rose 0.5 percent between mid-June and mid-August. A year earlier, loans increased 1.7 percent during the same time period. Outstanding commercial and industrial loans declined 0.9 percent, and real estate loans dropped 0.2 percent. Consumer loans rose 0.9 percent. Community bankers in the District are still having difficulty attracting retail deposits.

Agriculture and Natural Resources

On average, prospects for the corn and soybean crops are generally more favorable in the northern than in the southern portions of the District, as reports still indicate mostly good to excellent conditions. In the southern parts of the District, by contrast, scattered reports indicate that extended dryness has produced below-average harvested corn yields. Rainfall is reportedly needed in order for the soybean crops to reach their full yield potential. Still, the rice and cotton crops appear to be in mostly good shape.

NINTH DISTRICT--MINNEAPOLIS

Ninth District economic growth continues at a moderate to strong pace in most sectors. Ongoing robust construction helps pull the economy ahead and abundant consumer spending buoys retailing. Manufacturing apparently is growing slightly. Output is also steady to strong in energy, mining and agriculture, but low output prices in these sectors are squeezing producers financially and have retarded new capital investment. Banks are doing well overall. Labor markets remain very tight, with unemployment rates at or near historic lows in most areas, and many firms still cannot find needed workers.

Business and consumer sentiment appears much more guarded than earlier in the summer for a variety of reasons. Air travel dependent business is disrupted by an ongoing pilots strike. In some areas, the financial plight of farmers is casting a pall over the broader economy, while elsewhere recent international economic events and declines in capital markets are described as causes for concern.

Business Sentiment

In compiling information for this report, the number of sources who expressed concern about the near future is striking. Many referred to events in Asia, Russia or U.S. financial markets as a source of concern. Even those who said their own businesses were prospering voiced doubts that current prosperity would last. Nearly 45 percent of business and community leaders in North Dakota who responded to a Minneapolis Fed poll in late August described their outlook for the next 12 months as somewhat or very pessimistic. The corresponding number in the same region only 9 months ago was 13 percent. Low farm incomes are apparently a major factor here.

Banking

Banking conditions remain strong overall, but there is reportedly some weakening of credit quality and expectations of lower profitability for 1998 in agriculturally dependent banks. Such banks are reportedly responding to the less favorable agricultural conditions by tightening credit standards and attempting to diversify loan portfolios, according to one correspondent banker. Lending competition is reportedly fierce, especially for commercial loans in urban markets. In general, bankers are optimistic about performance during the remainder of the year. "1998 is looking to be a good year," remarked one correspondent banker.

Real estate and construction

"Fall building boom could trigger record," according to a Fargo, N.D., news article describing strength in residential, commercial and municipal building in that city. Similar strength is evident in Minneapolis – St. Paul, Eau Claire, Wis., and Sioux Falls, S.D. In Minnesota, where public building contracts are up 38 percent for the year through July compared to 1997, and where July

single-family residential permits were up nearly 22 percent over year-earlier levels, building clearly is a locomotive for the economy as a whole.

Realtors continue to describe strong business in new and existing housing as strong incomes and low interest rates fuel demand. One Minnesota-based agent says, “a lot of people are expressing some concern about the future of the economy, but they are still going ahead and making offers.”

Manufacturing

Little change from early summer is visible in the manufacturing sector where slight to modest growth continues. While a few firms with Asian or farm customers report declines, most manufacturers continue to enjoy good orders. With the exception of strike-caused interruption of some automobile component production, small and medium machine shops and component manufacturers are busy and complain more of labor shortages than of insufficient orders.

Agriculture

“Crop prospects are the best ever.” “Repayment ability has deteriorated drastically.” These comments from bankers responding to the Minneapolis Fed’s most recent survey of agricultural credit conditions outline the situation in agriculture. Yields of most major crops will be very good this year, and output of cattle and hogs is high. While this bodes well for consumers, Ninth District farmers face the most difficult financial situation in more than a decade due to low prices for most farm products. Nearly 82 percent of bankers responding to a Minneapolis Fed third quarter survey of agricultural credit conditions described farm incomes as low and below usual levels. Less than 2 percent described it as above normal. Few report higher loan losses or delinquency rates, but many say that some of their customers may be forced to liquidate if prices do not improve.

Energy and mining

Oil drilling remains subdued at about half the level prevailing two years ago. But work on new gas wells in Montana is somewhat stronger. Copper and gold mines are under financial pressure from low prices, but no further contractions are reported. Iron mine output apparently will be equal to that of 1997. Traditional lumber production continues well below historic levels in South Dakota and Montana and suffers from lower prices caused in part by weak demand in Asia. Oriented strand board plants face rising output prices and are reportedly running at capacity. Profitability in the paper industry reportedly varies greatly by class, but output is unchanged from earlier in the year.

Consumer spending and tourism

“Earnings to be ‘mindblowing’,” headlined an early September news story on second-quarter profits for a Minnesota-based national electronics retailer. National and regional retail chains based in the district also report robust sales across many categories of consumer goods. General consumer spending continues robust across many product lines. Reports on vehicle sales are somewhat mixed. They are generally strong in urban areas, and weaker in rural ones. A Montana General Motors dealer describes significant sales declines as a result of the strike but notes generally good demand overall. North and South Dakota dealers’ representatives describe moderate to good sales in larger cities, but very sluggish ones in smaller towns that are dependent on agriculture.

Tourist businesses across the district generally had a good summer season. Spokespersons describe cheap gasoline and favorable weather as beneficial factors. National destinations such as Mount Rushmore and Yellowstone and Glacier parks had somewhat higher visitation than in 1997. A source in South Dakota said that warm weather and crop conditions favor good fall hunting.

Employment, wages and prices

“Bus driver shortage keeps students waiting,” is a headline demonstrating yet another ramification of continued extreme tightness in Minneapolis-St. Paul labor markets. Many school districts in that region were short dozens of drivers as schools opened. Unemployment rates remain very low, in some cases at record low levels, in most urban areas of the district. Workers with computer skills are still in great demand. Sioux Falls, S.D., city government fears losing more such employees to private industry. Unemployment in Michigan’s Upper Peninsula is at the lowest level in many years, but at 5.9 percent remains well above district and national averages. There is also slack in labor markets in much of Montana. But despite such continued tightness, increases in direct wages are commonly in the 2 percent to 4 percent range.

Some worker reductions are occurring. A major manufacturing firm extended planned cuts from 4,000 to 4,500 persons as part of a restructuring hastened by overall decreased profits from Asian operations. A check-printing firm also increased announced layoffs from 2,500 to 3,500, as part of internal restructuring rather than weak demand.

Strikes are a more prominent feature of district labor markets than in many years. Telecommunications workers were off the job in August and a pilots strike continues to shut down a major airline. Both disrupted other business activity, with the airline strike having wider effects.

Prices remain in check. Motor fuels are at some of the lowest levels so far this decade. Weak Asian currencies are helping to keep prices of imported goods such as clothing, toys and consumer electronics low. Both manufacturers and retailers describe an intensely competitive business environment in which it is difficult to raise prices.

TENTH DISTRICT - KANSAS CITY

Overview. The district economy continued to grow moderately last month, fueled by further improvements in retail sales and construction and fairly strong activity in manufacturing. Even the recently weak energy sector experienced marginal improvements last month. In the farm economy, prospects for bumper corn and soybean crops have depressed crop prices, while pasture conditions have generally been good. Labor markets in much of the district were still very tight last month, and evidence of wage pressures, although present, remained relatively stable. Prices edged up at the retail level and for some construction materials. In contrast, prices for most manufacturing materials continued to decline as a result of the Asian crisis.

Retail Sales. Retailers reported sales improved further last month, following the robust performance in the past several months. Although most respondents expect sales to improve slightly over the next three months, retailers in general are less optimistic than in our previous survey. Inventories last month were practically unchanged. Retailers reported they are satisfied with current stocks and expect no major inventory changes in the near future. Automobile dealers reported marginal improvements due mainly to strong sales of light trucks. However, total sales were slightly lower than a year ago, leaving inventories unchanged. Most dealers are generally satisfied with current stock levels except for GM vehicles. Inventories are likely to expand in the coming months as new models are released.

Manufacturing. Tenth District manufacturing activity remained fairly strong last month with plants operating at high levels of capacity. Manufacturing materials were generally available, with only spotty evidence of marginal increases in lead times. Inventories last month were flat, and managers reported mixed feelings about their satisfaction with current stock levels. However, manufacturers plan to trim inventories somewhat in the near future.

Housing. Strong momentum continued in construction activity with builders reporting that housing starts remained relatively high last month, and well above year ago levels. Builders expect a

seasonal flattening in construction activity in the coming months. While sales of new homes were up again, they grew at a slower pace than in the recent past. The consistently strong sales have left inventories of unsold new homes at low levels. Mortgage lenders reported that demand last month was generally unchanged, but remained well above year-ago levels. Home purchases continued to account for close to half of mortgage activity. Although less optimistic than in our previous survey, lenders expect mortgage demand to stay modestly strong over the next three months as rates remain low.

Banking. Bankers reported that loans and deposits both edged up last month, leaving loan-deposit ratios little changed. Consumer loans, home mortgage loans, and agricultural loans increased, while other loan categories were generally unchanged. Increases in money market deposit accounts and large CDs accounted for the rise in deposits.

All respondent banks left their prime lending rates unchanged last month. Most banks also held their consumer lending rates constant, although a few lowered rates. Some banks expect to lower their prime rate and consumer lending rates in the near future, while others say they are unsure what will happen to these rates. A few banks tightened lending standards last month, citing concerns over economic conditions.

Energy. District energy activity rebounded slightly in August after falling in July. The district rig count was up 3 percent for the month but remains 22 percent below the level posted a year ago. The August rise in activity was likely a result of small increases in energy prices in July. Prices began to fall again in August, however, and the recent improvements are likely to be short-lived. The price of West Texas Intermediate Crude was down 4 percent to \$13.44 per barrel, the lowest average monthly price in more than 12 years. Natural gas prices plunged 16 percent, reaching their lowest levels since early 1997.

Agriculture. District corn and soybean producers expect a bumper crop, with some producers predicting corn yields 20 percent above normal. The exception to the strong conditions is Oklahoma, where producers may plow under fall crops due to drought damage, and ranchers face poor range

conditions and low prices. Elsewhere in the district, pasture conditions are generally good, but most ranchers are losing money due to low prices for feeder cattle. Likewise, operators of cattle feedlots in the district are suffering large losses and have cut back on purchases of feeder cattle.

In spite of low prices for most producers, district bankers are not overly concerned about the condition of their agricultural loan portfolios. Most portfolios are only slightly weaker than a year ago. In particular, most farmers and ranchers entered the current period of low prices with substantial equity to ride out the storm.

Wages and Prices. Labor markets remained very tight last month in much of the district, with continued, but not increasing, evidence of moderate wage pressures. Employers reported difficulties in hiring additional workers at almost all levels. Retailers complained mostly of a lack of entry-level and sales workers, while manufacturers reported labor shortages across the board, with production workers and engineers particularly scarce. Builders continued to face severe labor shortages as construction activity remained strong. Almost all respondents reported difficulties in finding and retaining information technology workers. Moderate wage pressures remained in place, although they did not appear to be intensifying from our last survey. Wage pressures continued to be concentrated in a few sectors, such as construction, and in particular areas of expertise, such as information technology. Prices edged up at the retail level and are expected to remain relatively constant in the near future. Prices for most manufacturing materials continued to decline as a result of the Asian crisis. Prices of some construction materials, such as cement, insulation, and drywall, were up slightly last month as builders faced increasing difficulties in obtaining them. However, builders expect prices of materials to remain stable over the next three months.

ELEVENTH DISTRICT--DALLAS

Eleventh District economic activity decelerated in August. Manufacturing activity declined. Demand for business services continued to increase, although there were pockets of weakness. Construction activity remained at very high levels, but with signs of softening in some areas. Loan demand was still strong, but financing for large office projects had slowed. Energy activity continued to decline. Rain provided drought relief for farmers and ranchers but was little help for the serious financial stress confronting some producers. Across a wide range of industries, business sentiment regarding the future weakened considerably in recent weeks.

Prices. Weak international demand continued to add to growing supplies and falling prices for many commodities. Natural gas prices have trended downward in recent weeks, and contacts expect prices to fall further because inventories are "bulging." Crude oil is still in heavy supply. Wholesale gasoline prices have been unchanged, but retail prices have fallen. Pump prices for regular gasoline of 90 cents or less are not uncommon in a few local markets. Prices are declining for oil and gas services and equipment, and equipment is again available in all segments of the industry, after being in short supply a few months ago. Petrochemical prices continued to fall, although contacts expect prices to stabilize at current levels into next year. Prices stabilized for a few plastic products in the early summer, but are still falling for others. Prices were down for primary metals, paper, soft wood lumber and liner board. Semiconductor and personal computer prices have fallen faster than expected.

Prices were mixed for service firms, mostly because rising wages were offsetting lower input costs for some companies. Difficulty finding qualified workers led to increasing wages and fees for business service firms. Transportation firms said declining fuel costs have offset wage pressures, resulting in unchanged fees and prices. Some retailers reported an increase in the volume of goods imported from Asia. Imports prices are lower than a year ago for some contacts, although one retailer does not expect to see price declines on Asian imports until goods are received next Spring. Most retailers said they are passing lower input costs on to selling prices, while others are keeping selling prices stable because input price declines are offsetting higher wage costs. On average, the price picture

has turned deflationary, and while wage pressures remain prevalent, ability to shift these pressures forward to consumers is absent in most industries.

Manufacturing. Manufacturing activity declined, as many producers continued to adjust to weak international demand and stiff import competition. Demand softened for personal computers, some construction-related products and was still weak for most semiconductor and energy products. New orders for personal computers were down, and contacts said inventories are up because the industry overestimated sales growth, particularly for computers over \$1000. Semiconductor orders remained weak and falling. Demand for cement was down, due to rain in parts of Texas and a drop in orders from oil service firms. Cement was no longer being allocated to customers, as it was a few weeks ago. Demand was up for lumber and wood products, mostly for commercial building, but contacts noted some weakening in demand for products used in the early phases of residential building. Demand for primary metals has declined, stemming from weak international orders. Fabricated metals firms said construction-related demand was still strong, although sales were weak to high-tech firms. Brick sales were up, but contacts expressed uncertainty about the long term outlook. Demand for corrugated boxes was still strong, but sales of liner board and other commodity paper were down because of weak international demand and strong import competition. Domestic demand for petrochemicals and plastics continued to be strong but “an inability to export” resulted in declining operating rates. Summer gasoline demand was “good,” but less than some had expected. Refineries have operated at unusually high levels of production and kept inventories full.

Services. Demand for business services continued to increase, but with some pockets of weakness, particularly serving customers in the oil and gas industry and, to a lesser extent, in consolidating industries such as banking and high-tech. Transportation firms, such as passenger airline, trucking and rail, reported an increase in activity. Service contacts were optimistic about the outlook, but some expressed concern about stock market declines impacting future business activity.

Retail Sales. Retailers reported continued “good” sales growth, at roughly the same rate reported six weeks ago. Contacts remain optimistic about the sales outlook. As one said, “customers will have to change their behavior” before the retailers change their outlook. Auto sales rebounded

some from softness in early August, but dealers expressed concern about the stock market affecting future sales.

Financial Services. Loan demand remained strong overall, and bankers reported no change in credit quality. Home equity lending was still strong, but contacts said auto and personal lending was slowing, partly because customers were consolidating loans to gain a tax deduction. Financing for larger office projects slowed, particularly within the last week, which contacts attributed to “the stock market slump” and “dramatic flattening of the yield curve.”

Construction and Real Estate. Construction activity continued at very high levels, but there are signs of softening in some areas of the real estate market. New home sales moderated from an “unsustainable growth rate” to a strong pace. Contacts said developers are pausing to reconsider planned office projects because office prices have stabilized and there has been a decline in preleasing of buildings currently under construction. Increased apartment construction led to slightly lower occupancy rates in some locations, and further weakening is expected. Hotel occupancies also weakened in some areas but remained very strong in others. Industrial market activity was still strong, although some contacts expressed concerns about overbuilding. Contacts fear companies may slow future travel and capital spending, which could weaken hotel occupancy rates and absorption of commercial space.

Energy. Drilling continued to decline. Gas-directed drilling in the United States is shrinking and oil-directed drilling is headed toward all-time lows. The U.S. rig count, at roughly 790 rigs, is down 22 percent from last December’s peak. Texas drilling, which peaked last November, has now fallen by a third. Demand for oil and gas machinery and services continues to decline along with the rig count. The decline was limited to domestic drilling on land for much of this year, but offshore and international drilling are now contributing to the drop in demand. Contacts report that, while layoffs have been relatively limited so far, significant layoffs are expected.

Agriculture. Rain provided some drought relief for crops and livestock, but it slowed harvesting and caused isolated flooding. Crop yields and quality are significantly below last year. Contacts reported that the combination of low yields and low prices has led to serious financial stress for many District crop producers and will encourage marginal farmers to discontinue production.

TWELFTH DISTRICT — SAN FRANCISCO

Summary

The Twelfth District economy expanded at a moderate pace during the most recent survey period. Sales of retail merchandise and services were brisk, although automobile sales were constrained by short inventories of new General Motors vehicles. Manufacturing activity was flat overall, largely due to slowing among high-tech manufacturers. Agricultural producers faced low prices and low yields for some crops. Real estate and construction activity generally was vigorous, particularly in California, although a few real estate markets softened elsewhere. Financial institutions faced strong loan demand and competitive supply conditions. The prices of most commodities remained stable or fell, but prices for some services rose noticeably.

Business Sentiment

District respondents expect tempered performance from the national economy and their respective regional economies during the next four quarters. About one-half of respondents expect national GDP to expand at its long-run trend pace. However, about one-third of the respondents expect national GDP growth to fall below its long-run trend. Just under one-half of the respondents predict that unemployment will rise, and nearly one-half expect inflation to rise. The percentage of respondents predicting stronger growth in their regions than in the rest of the nation remained high, at around two-thirds, although few expect further improvements in their regions' business and consumer spending, housing starts, and foreign trade balance during the next four quarters.

Retail Trade and Services

Sales of retail merchandise and services were rapid overall. Automobile sales were moderate; the total was held down by reduced availability of General Motors

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vehicles due to the recent strike. Supermarket food sales picked up in many areas. Sales of print and broadcast media space remained brisk. One exception to positive retail sales reports came from the Salt Lake City area; sales fell below expectations there, creating excess inventories and causing the cancellation of some merchandise orders. Hotel business volume was high in most areas, although signs of excess room capacity were reported for Utah and Las Vegas.

Due to sharp increases in the volume of East Asian imports, shipping prices for imports have risen substantially; inbound cargo charges are up 33 percent according to one garment industry respondent. Despite the sharp rise in import volumes, respondents did not report any delivery bottlenecks for retail items. Upward price pressure on retail merchandise has been curtailed by the availability of inexpensive imports and weak prices for commodities more generally. In contrast, the prices of services such as airline travel, health care, and cable TV reportedly have started to rise significantly.

Manufacturing

Activity in the manufacturing sector was flat overall, with weakness in high-tech manufacturing offsetting continued strength for some other products. Sales and market conditions weakened for computer and electronics manufacturers in many areas, with numerous reports of temporary layoffs and hiring reductions. In contrast, Boeing has resolved its production constraints and has operated at peak levels during recent weeks. Production activity also remained solid for durable items such as machine tools and for nondurables such as clothing, despite increased availability of inexpensive East Asian imports.

Among manufacturers and firms in other industries, investment spending on computer and information processing equipment reportedly has remained high due to Year 2000 conversion efforts. However, growth has slowed compared to recent years,

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particularly in some areas and industries where conversion activity is winding down. Respondents generally reported that investment in other plant and equipment was flat to down slightly on net.

Agriculture and Resource-Related Industries

Reports indicated weak conditions in the District's agricultural sector. Low recent yields on many crops in California's Central Valley reportedly were attributable to adverse early season conditions associated with "El Nino." In most areas, sales of crops and livestock have been held down by weak East Asian demand; the Alaskan salmon industry has been particularly hard hit. Due in part to import competition, prices for many agricultural products have been low. Grain prices have been especially depressed, and low potato prices reportedly have caused Idaho farmers to alter their harvesting plans.

Real Estate and Construction

Real estate construction and sales activity continued at a brisk pace in most areas. Both the San Francisco Bay Area and Southern California markets exhibited very strong conditions. Prices for residential and commercial space have risen rapidly in the Bay Area. New home sales reportedly were at a ten-year high in Los Angeles, and residential construction expanded further there and in San Diego. Despite declining vacancy rates, however, new commercial construction in these cities remained limited. Construction and real estate market activity reportedly was vigorous in Arizona and the Seattle area. In contrast, construction activity was flat or slowed somewhat in Utah and Oregon. Home price appreciation has decelerated in Utah, and expansion of nonresidential construction in Oregon has been held down by cutbacks in construction of new high-tech manufacturing facilities. In areas of the District where construction activity was rapid, finding qualified workers reportedly posed a significant obstacle to new construction.

Financial Institutions

Financial institutions faced strong demand for consumer, real estate, and business loans. However, credit quality conditions reportedly deteriorated a bit for some types of business loans, particularly to firms in manufacturing sectors with adverse market conditions. Competition between banks for qualified borrowers remained high.