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Summary of Commentary on _____

Current Economic Conditions

by Federal Reserve District

January 1997

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

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TABLE OF CONTENTS

SUMMARY	i
First District - Boston	I-1
Second District - New York	II-1
Third District - Philadelphia	III-1
Fourth District - Cleveland	IV-1
Fifth District - Richmond	V-1
Sixth District - Atlanta	VI-1
Seventh District - Chicago	VII-1
Eighth District - St. Louis	VIII-1
Ninth District - Minneapolis	IX-1
Tenth District - Kansas City	X-1
Eleventh District - Dallas	XI-1
Twelfth District - San Francisco	XII-1

SUMMARY*

Economic growth in December and early January was moderate in most parts of the country. Holiday season sales were in line with retailers' expectations of moderate growth. Manufacturing activity continued to grow, with significant strength coming from capital equipment and materials manufacturers. Bank loan activity continued at high levels, with mixed growth across Districts; some Districts reported signs of slight deterioration in consumer credit quality. Residential real estate markets remained stable or improved in most areas, and commercial real estate markets were almost uniformly tight. District reports provided scattered evidence of increasing wage pressures, particularly for skilled workers, but in general did not indicate significant price pressures other than for energy items.

Consumer Spending

Holiday sales improved over last year by small to moderate amounts that generally met retailers' expectations. Among Districts providing numerical reports, year-over-year holiday sales growth was 4 to 8 percent in New York, around 5 percent in Philadelphia, 7 percent in St. Louis, and 0 to 2 percent in Minneapolis. Virtually all Districts noted that the strongest sales were in small-ticket items such as apparel and toys; New York and St. Louis reported that jewelry also sold well. In contrast, consumer electronics showed weak year-over-year sales gains, with the

* Prepared at the Federal Reserve Bank of San Francisco based on information collected before January 13, 1997. 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.

exception of solid growth for large screen televisions and satellite dishes in Cleveland, non-computer electronics in New York, and general electronics in St. Louis. Retail sales of computer equipment in particular were disappointing, according to Philadelphia, Richmond, and San Francisco.

Accurate planning among retailers in general kept inventories on target for most product lines. As a result, price discounting was limited; the exceptions include reports of widespread discounting by retailers in Minnesota and discounting on apparel in Boston. Strong post-holiday sales in the New York and Chicago Districts contributed further to lean inventories in those areas.

Reports on the automobile market were slightly downbeat. Philadelphia, Kansas City, Dallas, and Minneapolis all reported slow December sales. In the Cleveland District, however, strong sales during the last two weeks of December left dealers optimistic that “marginally high” inventories there would return to preferred levels by February.

Manufacturing

Manufacturing activity held steady or expanded in most areas. The strongest sectors were those that produce steel and other metals, machine tools, construction materials such as lumber, and capital equipment for transportation and construction. Boston, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, and San Francisco all reported heightened activity in one or more of these sectors. Automobile and parts production reportedly expanded in Chicago and Atlanta, although Boston reported intense competition among auto suppliers there. In the high-tech sectors, semiconductor firms exhibited signs of recovery from a weak 1996, and computer firm shipments reportedly picked up following weak holiday sales. Both the Dallas and San Francisco Districts benefitted noticeably from these trends, and Minneapolis reported that

electronics manufacturers did well there. On the down side, furniture orders weakened in Richmond, and furniture inventories increased in Atlanta.

Among nondurable goods sectors, food processing in Minneapolis and poultry processing in St. Louis both expanded. However, apparel and textile production was weak in Richmond and Atlanta, as was the market for paper in Richmond and Boston. Petroleum producers benefitted from high prices and were operating at or near maximum capacity in Minneapolis and Dallas, with very low inventories reported by the latter District.

Nonfinancial Services and Tourism

The few reports on nonfinancial service activities were mixed. Richmond reported slower growth in service employment, due to declines in business and personal services, and Cleveland reported a decline in temporary employment, perhaps due to seasonal factors. In contrast, San Francisco reported strong growth in demand for telecommunications services.

Performance in tourist trade varied substantially across regions, due largely to weather considerations. Warm weather reduced downhill skiing business in the Richmond District but did not increase coastal tourism over last year's level. Minneapolis reported that extreme cold and stormy conditions in early January reduced winter sport tourism in the District. San Francisco reported reduced tourism in Northern California and Nevada due to recent flooding. In contrast, Atlanta reported excellent tourist activity, particularly in Florida: theme parks set attendance records there, and Miami was a popular destination.

Real Estate and Construction

Most areas experienced stable or rising demand and active construction, with noticeable strength coming from tight markets for commercial real estate. Atlanta, New York, Richmond,

Chicago, and St. Louis reported strong or rising commercial construction activity. Furthermore, Philadelphia and Dallas reported high levels of commercial leasing and sales and low vacancy rates. Boston reported increasing prices for commercial properties in Massachusetts.

Residential markets appear stable overall, with small improvement reported in some Districts and slight slowing reported in others. Where slowing occurred, however, building activity generally exceeded year-ago levels. New York and Chicago reported firming conditions in their residential markets. "Boom" conditions persisted for residential markets in many portions of the Minneapolis district. Residential housing sales eased somewhat in Richmond, although permits were up there. Kansas City noted some slowing in housing starts and sales, with the latter confirmed by a reported decline in mortgage lending. Within the San Francisco District, real estate markets were strong in most areas; California was the primary exception. Although total building activity in California continued to be weak, home sales and prices rose in some parts of the San Francisco Bay Area, and the Los Angeles area showed signs of improvement following its prolonged housing slump.

Banking

Banks reported active loan markets overall, although with limited growth on average and more strength in commercial loans than in consumer and mortgage loans. Total loan volume grew in Cleveland, St. Louis, Kansas City, and San Francisco. In contrast, New York reported declines in all categories, with the sharpest drop in mortgage lending. Richmond reported that commercial loans "changed little," while demand for consumer and mortgage loans declined. Total lending was flat in Atlanta, Dallas, Philadelphia, and Chicago; credit card loans, however, expanded in the latter two districts.

Loan quality was reported to be good in most areas, except for concerns about consumer credit in some Districts. New York and Kansas City noted higher consumer loan delinquencies, and Cleveland reported rising consumer bankruptcies. Both Cleveland and Richmond described loan competition as “fierce.”

Agriculture

Reports on the agricultural sector were mixed, with inclement weather clouding the picture in some areas. On the up side, Kansas City reported a good winter wheat crop, and Richmond noted that its winter wheat crop was “on schedule.” Furthermore, Kansas City reported that reinvestment of strong 1996 farm revenues was reflected in higher sales of new farm equipment. On the down side, excessive rain interfered with field work and delayed corn harvesting in Richmond, and flooding damaged some crops in the San Francisco District. A December cold snap hurt vegetable crops in Dallas, although citrus crops were spared.

Livestock conditions also were mixed. Cattle feeding costs were reduced by warm weather in Richmond but increased by cold weather in Minneapolis. In San Francisco, heavy rains improved grazing conditions for a time, but later flooding necessitated herd movement to less attractive grazing areas.

Employment and Wages

Wage increases were reported to be moderate overall, despite widespread reports of continued wage pressure for various skilled worker groups. Excess demand for skilled manufacturing, administrative, or technical workers—particularly computer technicians—was noted by Boston, Philadelphia, Cleveland, Atlanta, St. Louis, and San Francisco. Richmond reported that “wage pressures were more evident” in general, and Chicago identified “signs of

increasing wage pressures.” Furthermore, labor markets were uniformly tight in Kansas City, St. Louis, and Minneapolis. However, no District reported large year-over-year wage increases; reported numerical increases were 2 to 4 percent in Boston, “less than 4 percent” in Philadelphia, and 2 to 3½ percent in Minneapolis.

Prices

Price pressures were moderate overall, with the primary exception of sharply rising energy costs. The prices of manufacturing raw materials or goods were characterized as stable in New York, Philadelphia, Cleveland, and Minneapolis, and earlier pressure on construction costs in the Chicago District has eased. In Richmond, however, “price increases were more widely reported” than earlier, and Dallas noted rising prices for some raw materials and retail products. St. Louis reported that “recent increases in energy prices are being passed along to customers” in the transportation industry.

FIRST DISTRICT - BOSTON

The First District economy continues to expand at a moderate pace. Retailers say sales in the holiday period were modestly higher than a year earlier and mostly in line with their expectations. Over half the manufacturing contacts report rising or unchanged revenues. Commercial real estate markets are fairly stable, with activity more robust in Massachusetts than elsewhere in New England. Insurance company results vary among products.

Prices of manufactured goods are said to be generally level, although manufacturers report paper prices are down sharply, while prices of selected other materials have risen modestly; some manufacturers' selling prices, largely for certain business services and consumer products, are also up modestly. Retailers also say most prices are stable, but they cite price increases for high-end apparel and tourism, and significant discounting for low- to mid-range apparel and appliances.

Retail

Most contacts in the retail sector saw a modest increase in sales for the fourth quarter that was in line with expectations. As a result, their inventories are right on track, with no over- or under-stocking reported. Some sectors were stronger than expected (building materials, apparel, food, and tourism). Strong apparel sales, however, are attributed in part to significant price discounting in the low to middle ranges. Sales of appliances, personal computers, and consumer electronics declined in the quarter, but in line with expectations. Respondents expect a continuation of modest sales growth through the first half of 1997.

Employment is said to be increasing in line with consumer spending and this steady growth is expected through 1997. Wages are reported to have risen slightly in the last quarter and this trend is also expected to continue.

All respondents indicate that competitive pressures are constraining their ability to raise prices, even with increased demand. Costs are stable, so profit margins are generally holding. However, some sectors

(low- to middle-range apparel and appliances) report significant price discounting and lower profit margins. Only two sectors (high-end apparel and tourism) are reporting price increases on account of higher demand, and these increases are characterized as a recovery of ground lost to discounting earlier in the year; they expect competition to constrain further price increases. No contacts except those in tourism plan to expand capital significantly in 1997. Overall, retail respondents see modest and sustainable growth continuing through 1997.

Manufacturing

Half of the First District manufacturers contacted have experienced revenue gains from a year ago. Substantial increases are reported for innovative technology products, furniture, selected consumer items, and some business services provided by manufacturers. Revenues have been flat or declining for the remaining half of the sample. Paper prices are down sharply as a result of excess capacity in the industry. Intense competition has resulted in declining business for some automotive suppliers.

Most contacts report that materials prices have been flat or declining. In some cases, this is due to more aggressive dealings with suppliers or the appreciation of the dollar relative to the yen. Manufacturers mention small to moderate increases in the cost of plastic resins, gelatin, abrasives, and furniture-grade maple. Selling prices are reported to be stable or rising up to 3 percent. The increases are largely for business services and consumer products.

Manufacturers do not anticipate much change in overall employment levels in 1997. Demand is rising for professional, sales, and services employees, while productivity gains are limiting the need for production workers. Most contacts indicate pay increases of 2 to 4 percent in 1996, with similar raises projected for 1997. Compensation packages are escalating more for high tech workers and some managers. Companies report aggressive competition to hire hardware and software engineers. Health care and other benefits do not appear to be creating much, if any, cost pressure, especially with the continued adoption of managed-care health plans.

Most manufacturers expect a positive macroeconomic environment in 1997, although some mention a stock market correction or consumer indebtedness as possible sources of weakness. One-half of the respondents have aggressive capital spending plans.

Commercial Real Estate

The commercial real estate market in New England has not changed much during the last quarter. Massachusetts continues doing extremely well, Maine is still relatively weak, and activity levels in the other states in the region remain between those two.

Massachusetts has experienced a significant increase in demand for commercial space, especially in the Greater Boston area. Since there has been little new construction, vacancy rates are down and prices are rising. High prices for downtown office space have induced many new companies to locate in the suburbs. While prices have almost reached their 1980s levels, banks' reluctance to lend for real estate is said to have limited speculative construction.

Outside Massachusetts, market conditions are mixed. Some sectors are seeing declining vacancy rates and increasing prices, but others still have high levels of inventory. Retail real estate markets have been strong in most places, mainly due to the mild winter and a successful holiday season. Contacts report no major new construction projects in their states. Most respondents are optimistic about the outlook, anticipating steady prices and decreasing vacancy rates during the coming quarter.

Nonbank Financial Services

Respondents at insurance companies report continued weak sales of life insurance in the fourth quarter and strong sales of mutual funds and variable annuities. Employment moved down slightly in the fourth quarter. Consolidations in the insurance industry are expected to continue in 1997, contributing to further reductions in employment.

SECOND DISTRICT--NEW YORK

The Second District economy has a slightly firmer tone than in the last report, while price pressures remain subdued. Major retailers report that holiday-season and post-holiday sales were on or above plan. Persistent strength in the commercial and multi-family real estate markets finally appears to be spurring a pickup in development and construction activity; the single-family housing market continues to lag. Regional purchasing managers' reports were generally upbeat in December. Tourism remained strong through year end. There has been no evidence of increased price pressures since the last report. Finally, regional banks report some softening in demand for residential mortgage loans; delinquency rates rose for consumer and home mortgage loans, but declined for commercial loans.

Consumer Spending

Most major retailers report that holiday sales in the region were above plan, with November-December same-store sales running 5-8 percent higher than a year ago, helped by a surge in the final days before Christmas. Post-holiday sales were also reported to be strong, with one contact observing fewer than usual merchandise returns. A separate survey of small retailers across New York State shows same-store sales up 4-6 percent from 1995, and generally close to plan, with the strongest reports coming from Manhattan. Both large and small retailers noted that apparel, as expected, was the strongest category— particularly women's and children's apparel—along with jewelry. Big-ticket durables, such as home furnishings, appliances and electronics were generally weak, though a few contacts at large chains remarked that toys and electronics (other than computers) sold fairly well. One major discounter noted strong post-holiday demand in the home improvement category.

Most of the retailers surveyed report that inventories are in good shape; however, many electronics stores were left with large stocks and one major general merchandise chain mentioned some overhang of home appliances. There was reportedly less aggressive discounting than a year earlier but

still more than most contacts had anticipated. Merchandise costs were said to be flat to declining, and there were no reported wage pressures; thus, most retailers saw improvement in gross margins, compared with the 1995 season.

New York State sales taxes on most apparel are being waived for the week starting January 18, prompting many retailers to delay inventory clearance sales until then; this may give some boost to January retail sales, at the expense of February.

Construction & Real Estate

The region's real estate markets continue to firm. Even the lagging single-family housing market has registered steady but gradual improvement. Realtors in New York and New Jersey estimate that fourth-quarter existing home sales rose 3-4 percent from a year earlier, with prices up 2-5 percent. While builders have grown a bit more upbeat about the market for new homes in recent weeks, they emphasize that overall building activity is still only barely above the depressed levels of the early 1990s.

In contrast, the tight apartment market in the New York City area is evidently spurring a pickup in multi-family development. More than twice as many apartment units were authorized by building permits in 1996 (mostly in the second half) as in any of the prior five years. This is consistent with anecdotal reports: industry contacts in New York City say that a large number of residential projects are underway or set to get underway in 1997. In addition, one industry expert estimates that 2,500 new residential units will be created from a wave of office conversions in Lower Manhattan next year.

Strength in the region's commercial markets is also spurring new development. Major commercial projects underway in New York City in 1997 include a new terminal at Kennedy Airport, a high-tech commodity exchange trading floor, three major entertainment complexes, three new hotels, and a number of major superstores and supermarkets. The office market also continues to firm; vacancy rates across the New York City area continue to fall, though asking rents remain virtually flat.

Other Business Activity

Regional purchasing managers reports were generally upbeat in December. Buffalo purchasing managers report continued strength in new orders and a pickup in hiring activity, but some slowing in production activity; they also reported a modest increase in cost pressures. New York City purchasing managers report continued growth in the manufacturing sector, though at a slower pace than in November. [Those in non-manufacturing sectors reported strong improvement in business conditions in December.] Prices were reported to be essentially flat.

Unemployment edged up 0.1 point in both New York and New Jersey in November; the payroll survey showed a sharp decline in government payrolls, offset by an acceleration in private-sector job growth. Some firms in upstate New York report shortages of educated entry-level workers and computer programmers. Consumer confidence climbed to its highest level in more than six years in December, though it is still lower than in any other region. Tourism was reported to be exceptionally strong in the fourth quarter, with hotel occupancy rates holding near record highs.

Financial Developments

According to a survey of senior loan officers at small to medium sized banks in the District, demand for all categories of loans weakened somewhat since the last report. The decline was sharpest in the residential mortgage segment. Refinancing activity for all types of loans declined slightly. Overall credit standards were largely unchanged, though there was some tightening for consumer loans.

Average loan rates declined for all types of loans, with rates lower at 25 percent of banks and higher at just 3 percent. In contrast, average deposit rates increased, with 27 percent of the participating banks reporting an increase and only 6 percent reporting a decline. Delinquency rates continued to edge up for consumer and residential loans, but they declined for commercial, industrial and nonresidential mortgage loans.

THIRD DISTRICT - PHILADELPHIA

Reports from Third District business contacts in early January suggest that economic activity in the region has been moving up slowly. Manufacturers said orders were increasing and they have stepped up shipments. Most retailers indicated that they met their planned sales levels for the Christmas period--around 5 percent above 1995--but electronics and computer stores failed to match either their expectations or their year-ago results. Auto dealers said sales dropped seasonally in December but they expect a rebound soon. In general, both manufacturers and retailers indicated that inventories were around planned levels. Bankers reported a seasonal increase in credit card lending but said other types of lending have been flat.

Businesses in several areas of the Third District noted continued hiring, especially in some service industries. However, manufacturers have generally not been seeking to increase employment, although they continue to say they need skilled workers in some specialized occupations. According to reports from some major employers in the District, there does not appear to be an acceleration in the rate of general wage increases.

MANUFACTURING

Manufacturing activity picked up in early January after a slow December, according to reports received from Third District industrial plants. New orders were moving up, and shipments were increasing slightly while order backlogs were falling. Inventories increased slightly. Producers of durable goods reported slightly stronger demand for their products than did producers of nondurable goods.

III-2

Area manufacturing firms are expecting some improvement in the first half of the year despite the current slow start. On balance, they predict rising orders and shipments over the winter and spring, but they are not planning to build up inventories in anticipation of the increased demand for their products.

Industrial prices have shown virtually no change; manufacturers said both input costs and output prices have been mainly flat in recent weeks. Although a few manufacturers said they expect some price increases will be announced by their suppliers early in the year, they are not certain these higher prices will be effectively implemented.

RETAIL

Most Third District retailers contacted in early January said their sales for the Christmas shopping period met planned levels, which called for a year-over-year increase of around 5 percent, in current dollars. Several department stores reported that their gains were even greater, but some stores concentrating in electronics and personal computers failed to meet expectations, and some of them saw sales decline from the levels of Christmas 1995. Unplanned discounting appeared to be minimal in the final days before Christmas as well as in the week after. Several stores noted that they ran out of popular items before Christmas and were unable to replenish stocks. Most retailers said their inventories were at desired levels as the new year began, and some described them as below normal.

Auto dealers in the region said sales dipped seasonally in December but they expect a rebound soon. Inventories varied among dealers but appeared to be around planned levels overall. In general, dealers expect sales in 1997 to be about even with the 1996 total, and they expect sales of light trucks and sport-utility vehicles to continue to be relatively stronger than

sales of sedans. Although some manufacturers' rebate programs have been extended into the new year and some reduced finance rates have been offered recently, dealers do not anticipate an extensive increase in these promotional strategies.

FINANCE

Bank lending picked up seasonally for consumer loans, mainly credit cards, in mid-December, according to Third District bankers, but other credit categories have been flat. Most bankers continued to say competition for new business loans was strong and there was currently little net growth in business loan volume among major banks in the region. While some bankers and other business contacts said many firms were planning increased capital spending in 1997, bankers said they have not seen any indications that this will result in significantly stepped-up borrowing by either current or new customers.

LABOR DEMAND

Increased employment has been evident in some areas of the Third District recently. Businesses in central Pennsylvania and Delaware indicated that they have added workers and are looking for more. Most of the job gains have been in service industries. Manufacturing employment continued to drift down in most of the District, but demand for skilled manufacturing workers, such as machinists and tool makers, is reported to exceed the supply of available workers in many areas. The occupational categories for which there has been relatively strong demand are administrative and data processing workers and truck drivers. Despite the signs of increased labor demand, most of the employers reporting on their latest companywide pay increases are raising wages less than 4 percent, around the same as recent annual increases.

IV-1

FOURTH DISTRICT - CLEVELAND

General Business Conditions

The District economy is holding steady at a good level, with many areas reporting joblessness near--or below--the national average. Business activity remains especially strong in the central Ohio and southeastern Ohio/northern Kentucky regions, although virtually every major area reports favorable economic conditions. Even in southwestern Pennsylvania, where business activity has been more moderate, joblessness has fallen to a six-year low.

According to District employment agencies, hiring of temporary workers slowed slightly in December, mostly likely due to seasonal cutbacks. Still, employment growth remains above its rate at this time last year, and demand for general clerical, data processing, and technical positions continues to be strong. Wage growth has picked up somewhat, especially for technically skilled workers such as engineers. Employment agencies also report that benefit packages at smaller firms have increased as a result of tightened labor markets.

Manufacturing

Manufacturing production is rising and orders growth appears to have improved a bit recently. Capital goods producers continue to be especially upbeat in their appraisal of business conditions, although materials producers also see improvement. Local reports indicate that steel demand has strengthened and prices have risen, and many District

IV-2

producers plan to expand their production capacity this year. Elsewhere, commodity prices were unchanged, or only slightly higher from the last District report.

Manufacturing employment is steady or moderately higher, and wage increases are reported to be light despite generally tight labor markets. Still, manufacturers say that finding qualified workers remains a challenge.

Retailing

District retailers report mixed results for late November and December sales. While retail spending appears to have been stronger than for the same time last year, some retailers expressed disappointment in holiday-season receipts. Sales of electronics remain soft (although large screen televisions and satellite dishes are selling well). Items in demand during the holiday season included apparel, toys, and some household goods such as appliances. There was no strong consensus that the shortened shopping interval between Thanksgiving and Christmas had an adverse effect on total sales for the period.

Retail inventory levels are reported to be "on plan," in part because of conservative stockpiling prior to this shopping season. Several major retail chains have plans to open stores in the District this year, whereas very few report plans to close stores.

Auto Dealers

1996 was a good year for District auto dealers. All of those surveyed reported sales at or exceeding 1995's high levels. While October and November were somewhat weaker than in the previous report, the year ended on a positive note with a surprise surge

IV-3

in the last two weeks of December. Overall, the auto sales outlook for 1997 ranged from uncertain to fairly optimistic.

Dealers describe their inventories as marginally higher than desired, but they anticipate very little difficulty returning to preferred levels by the end of February. Still, respondents characterize the new-car market as extremely competitive. Several dealers note a drop-off in demand for used cars, breaking a two-year upward sales trend in this market.

Banking and Finance

Lending activity in the District was good at the end of the year, according to District bankers. Growth in consumer loan demand is moderate overall, with strong gains in seasonal credit card use. Commercial loan demand is also reported as moderate-to-strong.

The growth rate of delinquencies has leveled off somewhat, with some bankers reporting a drop in past-due loans. However, many bankers note a rise in household bankruptcies, which in some cases occur without experiencing credit delinquency.

Most respondents describe competition for borrowers as fierce. The spread between lending and deposit rates has tightened as depositors continue to move savings into higher yielding money-market accounts. Bankers report mixed credit quality trends, about half see no recent change, while the others see a slight deterioration. Some lenders report a tightening in credit standards for credit cards.

FIFTH DISTRICT-RICHMOND

Overview: Fifth District economic activity remained at a high level in recent weeks, although the rate of growth has moderated. Retail sales rose sharply since October and the commercial real estate market remained strong. Service sector growth slowed as did growth in state revenues. Manufacturing activity was mixed and loan demand slackened. Unfavorable weather hurt ski resorts' business and hampered crop harvests. Labor markets tightened further, and wage pressures were more evident. Price increases were more widely reported; retail and service sector prices rose more quickly, and commercial rents continued to rise.

Retail Trade: The pace of retail activity escalated since the last Beige Book report. Retailers reported robust gains in apparel sales, but indicated that general merchandise and computer sales were down. Shopper traffic and inventories at most stores expanded at a faster pace in recent weeks, although some automobile dealers reported declines in both. Retail employment grew more quickly, and retailers, particularly in urban areas, had difficulty finding employees. Wage pressures continued to be widely reported. Respondents noted that retail prices rose somewhat more quickly, and they expected slightly higher prices and increased demand for their products over the next six months.

Services: The service sector grew more modestly in recent weeks, held back by declines in business and personal services. Employment growth remained modest and the rapid pace of wage growth reported in the last Beige Book slackened. Wage pressures were less pronounced in the wholesale trade, finance, and insurance industries, however, some contacts in the hotel industry noted that tight labor markets were "driving [their] pay scales higher." Prices at service-producing firms rose more quickly. Looking ahead, respondents expected demand for services to be steady over the next six months.

Manufacturing: Activity in the District's manufacturing sector was mixed. Shipments were lower in the textiles, furniture, and paper goods industries. In contrast, shipments of metals, lumber, chemicals, and transportation equipment strengthened. Generally, the volume of new orders increased at a faster pace. However, producers of paper products, furniture, and rubber

and plastics reported fewer orders. Despite increased hiring by tobacco and transportation equipment firms, manufacturing employment fell somewhat during December, as textiles, furniture, and chemicals firms trimmed payrolls. Shorter hours at textile, furniture, and paper plants trimmed the average workweek. Finished goods prices declined and raw materials prices grew at a slower rate.

Tourism: Unseasonably warm weather hampered tourism in late December and early January. Respondents reported that a lack of natural snow and the inability to make snow closed some ski areas and limited the number of trails that others could operate. Despite the shutdowns, one contact from a popular ski resort stated that if the weather cooperates for the rest of the winter, they could still surpass their record-breaking 1996 season. Many contacts at coastal areas noted that despite unseasonably warm weather, tourist activity had slowed from November, although winter hotel bookings were about the same as last year.

Temporary Employment: The demand for temporary workers increased during December and early January, as qualified help remained in short supply. Most contacts noted an increase in the demand for light-industrial workers while the need for information technology workers remained high. One North Carolina agent reported that more employers in his area were seeking managerial-level employees. Wage pressures continued, especially in areas of low unemployment. In the tight Spartanburg, S.C. labor market, a contact said that offers of higher wages were starting to attract workers from low-paying permanent positions.

Finance: District banks reported somewhat lower demand for mortgage and consumer loans during December and early January, while commercial loan demand changed little. Contacts attributed the drop in mortgage lending to an uptick in interest rates. One Virginia banker indicated that higher rates "put the brakes on" customer interest, bringing the demand for home loans "to a screeching halt." Several bankers said that high debt levels generally slowed consumer lending activity, although they noted an increase in debt consolidation loans. The demand for commercial loans held steady, but contacts reported that the competition for those loans had become "fierce," leading banks to provide added service and to trim pricing.

Residential Real Estate: Residential real estate activity eased slightly during December and early January. Housing starts and sales were lower, although the number of building permits

increased slightly. Home prices moved marginally higher. Customer traffic was steady, and several homebuilders noted that the interest shown by "serious" customers had improved. Homebuilders reported that subcontractors remained in short supply and that lumber prices rose sharply through November but have stabilized in recent weeks.

Commercial Real Estate: The pace of commercial real estate activity accelerated in recent weeks. Office, retail, and industrial leasing activity picked up, except in North Carolina, where it remained at a high level. Commercial vacancy rates continued to fall, and rents rose slightly in most jurisdictions. The availability of prime office space tightened further, and numerous contacts reported shortages. Many respondents noted an increase in build-to-suit construction.

State Revenues: State revenues have increased at a slower rate since October. General fund collections were mixed across District states, ranging from modest growth in South Carolina to a sharp drop in Virginia. A Maryland contact said that poor lottery ticket sales had reduced general fund collections in her state. Withholding tax collections grew sharply in West Virginia, but rose modestly elsewhere in the District. Retail sales tax collections increased at a faster rate; a contact in West Virginia noted that sales tax collections had remained strong for three consecutive months, following nineteen months of "sluggish" performance.

Agriculture: Wet weather across most of the District during December hampered farmers' ability to do fieldwork. Persistent rainfall delayed corn harvesting and prevented ground preparation in many areas. However, winter wheat was developing on schedule. In the livestock sector, mild temperatures reduced the amount of hay needed to feed cattle. In the dairy industry, falling prices continued to force some small producers to leave the industry. Hog producers in North Carolina faced higher costs as the lack of sufficient slaughter facilities required them to ship hogs to plants in other states.

SIXTH DISTRICT - ATLANTA

Overview: Contacts around the Sixth District report that economic activity continues to grow at a moderate pace. Retailers' reports on December sales were mixed. A slight decline in production and new orders was noted in the manufacturing sector, while tourism and business travel was generally reported to be at high levels. Single-family home sales varied across the District, while commercial real estate markets continued to improve. Banking contacts reported flat loan demand. In spite of shortages of qualified workers, industry contacts report that wages generally appear to be holding steady.

Consumer Spending: District retailers give varied reports on December sales; on balance these are positive. The majority of retailers reported that sales exceeded year-ago levels, with a significant number of those reporting strong increases. Almost two-thirds of the retailers contacted said that holiday sales met or exceeded their expectations. Apparel sales had by far the strongest showing across the region. Inventories were described as low or on target in much of the District. Looking forward, most retailers anticipate that first quarter District sales will be up slightly compared with last year. Additionally, most retailers do not expect labor or product prices to rise over the next six months.

Manufacturing: More factory contacts note declines in production, new orders, and the factory workweek since the last Beigebook. Despite these declines, more also expect production to accelerate in the coming months, although over half of the manufacturers contacted expect to maintain current employment rolls. Suppliers for the region's auto and recreational vehicle plants note increasing shipments. Lumber manufacturers are pleased with shrinking inventories and paper manufacturers note improving sales, although a glut of wood pulp is hurting some companies.

Producers of electrical equipment and appliances report an increasing workweek and improving new orders. Commercial and Department of Defense aircraft orders are benefitting aircraft engine producers in Florida and Louisiana. Less positively, inventories are reported to be excessive for some furniture producers, orders are falling at a large packaging firm, and employment rolls continue to contract at some apparel mills.

Tourism and Business Travel: A strong tourism and convention sector is expected to continue to support the region's economy in coming months. Local markets in central Florida, where theme parks are breaking attendance records, report increases in hotel occupancy. Theme parks on Florida's space coast have recently announced expansion plans in addition to park expansions already underway in central Florida. South Florida appears to be experiencing one of the best tourist seasons on record with good weather and little negative news about crime, according to tourism officials. Hotel bookings for spring are up from a year ago in Miami. Trends in the New Orleans hotel and hospitality industry reportedly remain positive with more emphasis being focused on foreign travelers.

Construction: According to real estate contacts, single-family home sales and construction varied widely in markets throughout the District on a year-over-year basis in December. The majority of contacts report that home inventories are adequate, although several builders expressed concerns that new home inventories may be moving too high. Realtors generally believe home sales in the first quarter will exceed the previous year's level, while most builders anticipate construction activity will be flat to slightly down. Most builders and Realtors contacted expect home prices to rise over the next six months.

Contacts generally report that commercial construction continues to increase. Declining vacancy rates and higher rental rates continue to drive forward new industrial, office, and retail development. Most commercial projects continue to be build-to-suits; however, several speculative projects are now underway and more are anticipated this year. Overall, the multifamily sector remains healthy; however, some markets have weakened.

Financial: Most contacts in the banking industry reported flat lending. Consumer loan demand was mixed with softness reported in automobile financing. Commercial loans were level, and mortgage lending slowed slightly. Overall loan quality held steady.

Wages and Prices: Locating and hiring qualified workers remains difficult, according to contacts in some industries, but wages appear to be holding steady in most cases. Contacts in Tennessee report that shortages of skilled workers are a common concern. Demand for qualified technology workers is said to be especially strong; some employers are resorting to out-of-state recruitment and signing bonuses in order to secure talent. More company contacts than before expect prices for materials and finished goods to increase moderately over the next few months.

VII-1

SEVENTH DISTRICT--CHICAGO

Summary. Overall economic activity in the Seventh District continued to increase moderately in December and early January amid signs of increasing wage pressures. Holiday retail sales gains came in above last year's lackluster results, but fell short of many retailer's earlier expectations. Housing and construction activity picked up at the end of 1996, and manufacturing activity increased at a modest rate. Bankers and other lenders reported that demand for both business and consumer loans remained strong, but showed little or no signs of increasing. The District's labor markets tightened further with many contacts reporting increasing wage pressures across the board. Agricultural reports show hog production was still behind year-ago levels, but many observers were skeptical.

Consumer spending. Most contacts reported that consumer spending gains in December were better than last year, but performance was mixed. Some retailers that met holiday sales targets reported using heavier than normal sales promotions, both before and after Christmas, to do so. However, other retailers went into the season with conservative sales targets and, as a result, had lean inventories which may have limited sales gains. For the most part, retailers experienced strong apparel sales, while electronics and home appliance sales remained relatively soft. One major retailer noted that increased debt levels may have made consumers reluctant to purchase big-ticket items. Inventories were considered by most merchants to be in good shape during the holiday period, which limited the need for unplanned price discounting and resulted in improved profit margins compared to a year ago. Overall, the region's holiday sales results were described as "OK" or at least in line with results in other regions, but fell short of earlier expectations. Several retailers stated that post-holiday sales have been in line with their holiday sales pace.

Housing/construction. Housing activity picked up moderately in December and early January, on a seasonally adjusted basis, and other construction activity continued to increase at a modest pace. New housing construction rebounded slightly from a short-lived slump earlier in the fall, with many contacts pointing to lower mortgage interest rates and strong labor markets as causes for consumer optimism. One home builders' association in Michigan described the market as "steady, strong" and noted that builders

VII-2

were optimistic heading into the new year. Another association in Wisconsin pointed to increased membership as a sign of increased activity. This contact also noted that advertising was down in the association's monthly publication, stating that building supply producers didn't need to buy advertising space, since they were already selling all that they could produce. Several realtors reported that sales of existing homes remained strong but may be off slightly from very high levels. Commercial construction activity continued to increase moderately with sources pointing to the suburban areas as particularly strong. One contact reported that construction of "category-killers" (strip malls anchored by large electronics or office/computer retailers) continued to be robust in Indiana. There were no reports of materials shortages and, with the exception of volatile lumber prices, few reports of upward cost pressures.

Manufacturing. Manufacturing activity at the end of the year changed little from the pattern of moderating growth that had been evident over the previous few months (aside from any disruptive effects from recent auto strikes.) Purchasing managers' indexes from across the District indicated flat to slightly increased overall activity in December compared to a more widespread, albeit slow, expansion in earlier months. A major appliance producer reported that shipments of their core products had again slowed toward the end of the year, after a brief uptick in October. An industry analyst noted that heavy construction equipment ended the year strong, due in large part to the strength in nonresidential construction. A major producer of machine tools reported that customer orders slowed in December and backlogs in some plants had eased. However, one of their plants that mainly supplies equipment to the auto industry reported that backlogs remained high. Steel producers noted that demand remained strong, with bookings solid into the second quarter. In addition, a metal fabricator reported strong demand through the end of 1996 with no sign of weakening in the near term.

Banking. Lending activity continued to be strong around the District in December and early January, but most financial institutions reported little or no growth in loans. On the commercial side, several banks noted that lending was being driven largely by mergers and acquisitions, which was widely dispersed among industries. One large bank contact stated that aggressive lending targets were exceeded last quarter, and some loans were shifted to the first quarter. However, one bank reported that loan volumes were bolstered by lowering credit standards and price, although overall credit quality remained relatively strong. A small bank noted an uptick in commercial loans in December due to

VII-3

short-term lending to auto distributors for carrying unplanned inventory, which would be cleared out in January. As a result, the bank's lending activity in January is expected to be down. Several other small banks characterized lending activity as sluggish. On the consumer side, credit card usage continued to rise in December. Other forms of consumer loans were also strong, but growth was modest compared with credit card lending. Most banks reported that mortgage lending (excluding refinancing) remained relatively strong but growth performance was varied, with some local markets showing declines and others showing increases.

Labor markets. Labor markets in the Seventh District continued to tighten amid more widespread reports of increasing wage pressures. Unemployment rates continued a downward trend through November (latest month available) from already very low rates. Several temporary help agencies reported that employers, after several months of stonewalling, were beginning to raise wages in December to attract qualified help. One agency contact described clients as "finally realizing that they had to loosen the purse strings if they wanted to fill a position" and another reported that "employers were upping their offers across the board." One labor market analyst reported that requests for a state-sponsored occupational wage survey were unusually high, a sign that the analyst felt indicated employers were preparing to raise their offers. All those contacted described wage increases as very modest but broad-based across occupations, except in those occupations where shortages (and wage increases) have persisted for some time. The shortage of accounting professionals noted in our last report intensified, while that of skilled construction occupations appears to have eased.

Agriculture. Agricultural analysts were surprised by a recent report that showed hog production continued to be behind year-ago levels. The report noted that hog numbers were down 3.5 percent from a year ago and the lowest in 6 years. Moreover, it suggested that the number of sows likely to give birth during the six months ending May will be down 1 percent. The reported cuts were especially large among District states; down 8.5 and 5.5 percent, respectively. The cuts imply that this year's rise in meat production will be somewhat smaller. However, many observers are skeptical of the reported cuts. The industry continues to undergo enormous structural change, adding to the larger estimating errors that have become apparent in recent reports. And other signs, such as a sharp cut in the number of sows shipped to packing plants and strong producer earnings, suggested that an expansion was already underway.

EIGHTH DISTRICT - ST. LOUIS

Summary

Economic activity has picked up since the last report. District retailers report holiday sales generally met or exceeded expectations, while auto dealers report sales relatively unchanged from a year ago. Other business contacts report continued growth in their industries and are optimistic about the near term; however, a survey of small businesses shows a less favorable outlook for the first half of 1997 compared with a year earlier. Tight labor markets still prevail in many areas. Contacts in the transportation industry report that recent increases in energy prices are being passed along to customers. Real estate markets remain strong in most parts of the District. Loan growth picked up at large District banks during the last two months of 1996.

Consumer Spending

Most retailers surveyed indicated that sales during the 1996 holiday season generally met or slightly exceeded expectations. On average, sales increased about 7 percent from the previous holiday season. Electronics, jewelry and toys were the big sellers. Post-holiday inventories are at desired levels. Most retailers expect moderate-to-good sales to continue during the beginning of this year.

Auto dealers stated that sales during November and December were generally unchanged from a year earlier. Used car sales are still increasing, but this has not substantially affected sales of new vehicles. Most dealers expect sales during the first half of 1997 to remain unchanged from, or be slightly better than, 1996 levels.

Manufacturing and Other Business Activity

Most District contacts are optimistic about their firms' near-term prospects. Tight labor

VIII-2

markets remain a problem for many employers, particularly those in the construction and information technology industries. Some retailers in the southern part of the District had difficulty finding holiday workers.

The District's poultry processing industry has been adding new capacity. In fact, one firm that will open a new plant this spring has already announced an expansion. Increased demand from fast-food restaurants has been pivotal in much of this growth. Makers of office electronic equipment are reporting recent capital additions, caused by increased demand, that will also create about 600 new jobs. Manufactured homes are selling well, leading to a new plant in western Tennessee that will employ 250 workers. The steel industry is following Toyota into southern Indiana, with the announcement of a new plant in the area that will employ more than 400 workers. A bank's mortgage division is adding 200 jobs in Louisville because of increased business from a recent merger.

Merger activity has picked up in the District, especially in the St. Louis area. Boeing announced it will merge with McDonnell Douglas. Because the company's defense systems division will stay in St. Louis, however, the merger is expected to have a minimal effect on the regional economy. Mercantile Bancorporation will buy Roosevelt Bank, the largest thrift in Missouri. About 50 branches are expected to be closed, 30 of which are in St. Louis. A Dutch insurance company, Aegon, is buying the Provident Corporation's insurance business. About two-thirds of the firm's 1,500 Louisville employees may lose their jobs.

A contact in the aerospace industry reports that there has been a 25 percent increase in fuel costs over the past year, which has negatively affected profits. In this vein, a large package delivery firm in the District announced that it will pass along recent increases in energy prices to shippers. Likewise, trucking industry contacts report that large carriers will probably push through a 4 to 5 percent increase in transportation costs.

Outlook

According to a recent survey of 231 small businesses in the Eighth District, the number of respondents expecting a deterioration in business conditions over the first half of 1997 outnumbers those expecting an improving outlook by two-to-one, although a little more than half expect little change. In general, firms in the trade sector were more upbeat, while those in construction and finance were somewhat less upbeat. A similar survey conducted a year ago indicated more optimism among small businesses.

Real Estate and Construction

Residential real estate markets remain strong in most parts of the District, with sales of both new and existing homes up slightly. Monthly residential construction permits in November, however, were down in all 12 District metropolitan areas. On a year-to-date basis, permits were up in almost all metro areas. Commercial construction is strong all around the District. Some commercial real estate agents have noticed a weakening in the apartment and industrial markets in the southern parts of the District, however.

Banking and Finance

Total loans outstanding at 11 large District banks rose 1.1 percent during the last two months of 1996. In contrast, total loans increased 0.1 percent in September and October and declined 0.1 percent during the last two months of 1995. All categories of loans showed increases, with consumer loans posting the largest increase, 1.9 percent. Total deposits rose 0.5 percent in November and December.

NINTH DISTRICT--MINNEAPOLIS

In the middle of a bitter winter, the economy of the Ninth District is growing moderately. Construction continues to animate many areas. Oil development is pumping cash into parts of three states, while mining and forest product output is generally steady. Manufacturers report generally good business with normal inventories and no price pressures other than in fuels. Severe weather is causing problems for cattle ranchers, and hog slaughter has dropped slightly compared to a year ago. Consumer spending apparently is guarded, with holiday retail sales only slightly above 1995 levels and cold weather reportedly slowing car sales. Tourism sector reports are mixed, but with some improvement in regions that had been slow. Labor markets remain very tight. Many employers report difficulty in securing needed workers, but few have given or anticipate large pay increases. Prices, other than for petroleum products, show little increase.

Construction and real estate

“Vermillion sees housing binge,” is a headline describing construction activity in one small South Dakota city that could apply equally well to several other towns of the same size in Minnesota, North Dakota or South Dakota. “The boom rolls on,” headed a report on Minneapolis-St. Paul residential building that concluded, “industry experts expect the good times to continue.” Generally strong fiscal positions for most district state governments point toward increased public-sector construction in 1997, according to one industry official. Realtors report good business for the season, after some slowness in mid-1996.

Natural resource industries

Oil and gas continue as the natural resource sector’s strongest component. Rig counts are holding up well despite bitter weather. Western North Dakota is the most active area, but two or three rigs have been drilling in South Dakota, a state that usually has no such activity. Iron ore and nonferrous mining output is largely stable. Paper, lumber and building board output shows little change compared to prior quarter and year-earlier levels. Higher prices for dimension lumber, described as resulting from curtailed imports from Canada, have improved profitability for sawmills in the western portion of the district that have faced higher acquisition costs for timber in recent years.

Manufacturing

“Business is very good, our backlog of orders is the highest it has ever been,” reports one North Dakota manufacturer with a national market. Electronics and other technology firms also reportedly are doing well. A mining equipment manufacturer and fabricators of agricultural implements reportedly have strong orders. North Dakota continues to add to its agricultural processing capacity: A 100-employee pasta plant and a corn sweetener plant recently went on line. One exception to this general pattern is a South Dakota manufacturer of tourist industry specialties who reports, “We are slow, it was a very soft summer.” Industry sources report normal inventories, with no delays and few price pressures in raw materials.

Agriculture

Extreme cold and unusually deep snow are the most recent scourge for cattle ranchers. Early and deep snow precluded the use of winter pastures and forced ranchers to dip into hay supplies earlier than usual. Extreme cold increases the nutritional requirements of cattle and thus of hay consumption. These factors have led to sharp increases in the prices of hay in Montana and the Dakotas, further increasing ranch losses. Blizzards over the first weekend in January reportedly caused mortality in cow herds in north-central South Dakota, but no good estimate of losses is yet available. However, if ranchers can weather the season, some hope glimmers in the new year. Many district livestock market analysts believe the price trough in the cattle cycle was passed in 1996 and that ranchers should see some return to profitability in 1997 with further improvement in 1998.

Hog prices are somewhat higher than in the first half of 1996, and with lower feed costs following harvest, hog producers are doing better than a year ago. Hog slaughter is down slightly from year-earlier levels.

Consumer spending

“People are a little disappointed,” says one St. Paul, Minn., mall manager in an assessment of the 1996 holiday shopping season that typifies much of the district. A check verification service estimated that Minnesota holiday sales were up less than 2 percent and the month of December itself was flat, both compared to year-earlier levels. Retailers in western Wisconsin, one of the fastest growing areas in the district, are somewhat more positive as are their counterparts in North Dakota. “Holiday business: merry but not memorable,” is how a Grand Forks retailer summed up the season. Consumer caution, widespread discounting and intense competition mark the sales environment described by retailing CEOs at a Minneapolis Fed

meeting. Reports on vehicle sales are mixed; some dealers reported good sales in late 1996, but association representatives agree that sales have slowed in recent weeks. Bad weather is blamed in part. "No one wants to go car shopping when the wind-chill is 60 below," says one.

Tourism and recreation

A Montana newspaper reports ski resorts in that state opened up to two weeks early and posted large year-on-year increases in November and December. Good snow conditions are keeping ski and snowmobile trails busy in South Dakota, according to a tourist official. But a ski resort operator in northern Minnesota reports a slight decrease in the number of visitors compared to last year's record pace, and the deer hunting season in Michigan's Upper Peninsula was disappointing for local businesses. These reports of greater strength in western areas of the district reverses a pattern of more optimism in the east that prevailed through much of 1996. Winter recreation businesses in Minnesota, Wisconsin and Michigan reportedly continue to anticipate good business, but extremely cold, stormy weather is eroding those hopes.

General business sentiment

Businesspeople who responded to a Ninth District poll at the end of 1996 generally expressed expectations of continued moderate economic growth in 1997. Nearly two-thirds expect business investment to increase in their community in 1997, and over half expected increasing employment levels. Less than a fifth expected wage increases in their community to exceed 4 percent while about a third expected their own firms would raise product prices. Over 80 percent of respondents characterized themselves as somewhat or very optimistic about their community's prospects for the next 12 months. Within this generally optimistic outlook, responses were most positive from northwest Wisconsin, Minnesota and eastern North Dakota. In general, the view from respondents in Montana and South Dakota was decidedly less bright.

Employment, wages and prices

Unemployment rates remain very low in most areas of the district, except for Montana and Michigan's Upper Peninsula, which are somewhat above the national average. Employers in many areas continue to express concern about securing needed workers. But most report pay increases of 2 percent to 3.5 percent. Flat health insurance rates have helped to keep overall compensation costs down. Petroleum products remain higher than a year ago, but are the only frequently mentioned higher price.

TENTH DISTRICT - KANSAS CITY

Overview. The district economy continued to grow moderately the past month, while showing a few signs of slowing. Manufacturing activity remained fairly strong. Holiday retail sales were somewhat less than expected, and construction activity edged downward. In the farm economy, the winter wheat crop remained in good condition and farm finances improved after an excellent fall harvest. Labor markets remained tight in much of the district, leading some firms to increase wages. Prices were generally stable at the retail level and for materials used in manufacturing and construction.

Retail sales. Retailers report holiday sales were up only slightly from a year ago and somewhat lower than expected. Sales are expected to improve somewhat in the coming months, and some retailers plan to expand stocks to meet increased demand. Automobile dealers report sales were generally down from the previous month and a year ago. Sales of sport utility vehicles and light trucks remained strong, however, and some dealers say they are still short of such vehicles.

Manufacturing. Manufacturers continued to operate at moderately high levels of capacity last month. Manufacturing materials were generally available, with lead times either holding steady or declining. Manufacturers have been trimming their inventories, and some say they plan further reductions because stocks exceed desired levels.

Housing. Builders report housing starts slowed last month while remaining above year-ago levels. Most of the decline in starts was in single-family homes. Builders expect little change in construction activity in the first part of the year. Sales of new homes also fell somewhat last month. Most building materials were readily available and delivery times were

normal. Mortgage lenders report demand was slightly lower last month.

Banking. Bankers report that loans and deposits both increased last month, leaving loan-to-deposit ratios little changed. Commercial and industrial loans, consumer loans, commercial real estate loans, and agricultural loans all edged up. Demand deposits, NOW accounts, and money market deposit accounts also rose, while small time deposits and large CDs were flat.

Respondent banks held their prime lending rates steady last month and expect to leave rates unchanged in the near term. Banks also held their consumer lending rates steady and plan no changes in the near future. Some banks tightened their lending standards on consumer loans, citing increased delinquencies.

Energy. District energy activity declined slightly last month. Oil and gas prices continued to rise in December and remained well above year-ago levels. Despite the high prices, the district rig count edged down 2.3 percent in December and was unchanged from a year ago.

Agriculture. The district's winter wheat crop is in good condition, with adequate moisture but no snow cover to protect it from the winter weather. Wheat pasture is excellent this winter, in contrast to the past few years. Farm income rose in the district in 1996 due to excellent crops and high crop prices. The rise in farm income in 1996 appeared to help main street businesses, and farm vehicle and equipment sales have been quite strong recently.

Bankers report the higher farm income also led to some overall improvement in farm loan portfolios in the district. The quality of loans made to crop producers improved substantially in 1996. Performance of loans to livestock producers was mixed, with stronger performance by loans to cattle feeders offsetting weaker loans to ranchers. District bankers expect farm income will be mixed in 1997. Crop producers may see their income fall as yields and prices return to

normal after an exceptional year in 1996. Lower feed costs and higher calf prices should help boost profits in the livestock industry this year.

Wages and prices. Labor markets were still tight last month, and there continued to be some evidence of wage pressures. Manufacturers report skilled and unskilled workers remained in short supply, and some companies say they have responded by increasing wages. Prices held steady at the retail level and for most manufacturing and construction materials. Retailers expect no major price changes in coming months.

XI-1

ELEVENTH DISTRICT--DALLAS

In December and early January, Eleventh District economic activity continued to expand at the slightly stronger pace established in late October and November. There were more reports of price pressures than in the last beige book, partly as a result of low inventory. Two industries reported that price pressures were less because new capacity had come on line. Most manufacturing activity was in a seasonal lull, with the exception of energy-related activity, which was strong. Retailers were happy but not overwhelmed with holiday sales. The financial services industry reported little change in lending, and construction and real estate activity continued at roughly the same level. High energy prices kept drilling and oil services activity strong. Agricultural producers reported generally good conditions, but would like more rain.

Prices. Prices were up for aluminum, brick, scrap metal, retail goods, heating fuel and oil service companies. Retailers said holiday selling prices were up one to two tenths of a percent above last year, and one contact said the company is "trying to get margins back to historical levels." Low inventories of heating fuels and bitterly cold weather in Europe and the U.S. sent fuel prices soaring in December. Heavy demand for oil service companies pushed their selling prices to a premium. Oil service firms reported a shortage of some skilled workers, such as machinists, as well as many kinds of equipment, from offshore rigs to measurement-while-drilling equipment. A shortage of scrap metal pushed prices up 5 percent over the last 30 days, and contacts expect prices to increase an additional 3 percent over the next quarter. Rising costs are expected to push up prices of corrugated box and liner board by 6-10 percent in February or March. A slight softening of chemical prices, combined with a run-up in natural gas and liquids prices, has squeezed profits for petrochemical producers. Some softening in the price of prefab steel building components was attributed to seasonal factors and

XI-2

additional capacity. Cement producers said a new terminal at the Port of Houston had increased supply sufficiently to hold prices steady.

Manufacturing. Manufacturing activity was in a seasonal lull, with the exception of computers and semiconductors which continued to rebound, and energy-related activity which remained strong. Demand had slowed, seasonally, for boxes and construction-related materials, such as fabricated metals, brick, lumber and concrete. An increase in demand led to low inventories of steel and scrap metal. Most construction-related manufacturing contacts expect a good year, although as one said "it will be hard to top 1996." Very strong demand and high levels of production continue for petrochemical producers. Gulf Coast refineries have been operating at full capacity in an effort to meet demands from an inventory running 16 percent under year-ago levels, and to take advantage of high prices. Maintenance of refineries has been widely delayed to continue heating oil production, and the usual December turnarounds to begin the transition to summer gasoline production have not taken place. With gasoline inventories at the lowest levels in recent history, this now raises the possibility of very tight supplies of gasoline this summer.

Retail Sales. Most retailers were happy but not overwhelmed with holiday sales. Contacts referred to the period as "O.K", "not great", "solid", "decent" and an "obvious improvement". Retailers said Texas sales were generally better than those posted by the nation as a whole. Several contacts reported that inventories were slightly lower than expected, with the exception of one company with higher inventory who had restocked based on better than expected sales. Contacts expect sales to continue at roughly the same pace throughout the first half of 1997, with some strengthening towards the third quarter. Two contacts mentioned concern about the high levels of consumer debt. Auto sales have been slower than expected.

Financial Services. The industry has seen little change in lending activity over the last six weeks. Residential real estate and commercial loan demand continued at the same pace, except in

Houston where increased construction and restoration of apartments pushed up commercial lending. Outlooks for the New Year remain cautiously optimistic for all loan types.

Construction and Real Estate. Activity continued at roughly the same level. Construction of industrial space was still strong, although demand had declined. Some contacts were concerned about the amount of supply coming on line, but others were optimistic that announced relocations would spur an increase in demand in 1997. Residential demand remained steady at high levels, and existing home sales were reportedly up in most major markets, with the exception of Austin where demand has softened. In the office sector, contacts said demand for space continued to improve, and rising occupancies are expected to continue pushing up rents in 1997, boosting office construction.

Energy. Oil services companies continue to report very strong demand and full utilization of capacity. There was no sign of the usual end-of-year build-up in the US rig count, which held steady between 840 and 860 for the last six weeks of 1996. These levels are the highest of the year, suggesting industry capacity is maxed out. A substantial increase in capital spending by producers is predicted for 1997, at least 15 percent, but oil service capacity must grow for this to materialize, and much could be eaten up by higher prices for oil services. Any increased activity will have to be land drilling, because contacts say every offshore rig available in the world is working now.

Agriculture. Land preparations moved ahead in most areas. Many areas could use a good rain at this point. In December, cold temperatures led to losses of some vegetables but citrus was spared any serious damage. A return to warmer conditions improved livestock performance, and haying activity slowed with the warmer temperatures. As this document was being completed, the effects of a deep freeze that hit the District are unclear.

TWELFTH DISTRICT—SAN FRANCISCO

Summary

Reports from Beige Book contacts indicate continued strong expansion in most Twelfth District states toward the end of 1996. Retailers reported a good holiday selling season, although adverse weather conditions in late December and early January held down post-Christmas retail activity. Early January flooding in Northern California and Nevada also caused extensive damage to homes, farms, highways, and tourism facilities. Some efforts to repair damage began immediately, boosting residential and non-residential construction, which have generally been strong in District states other than California and Hawaii. Manufacturing activity continued to increase in recent months, putting some pressure on wages for skilled workers, particularly in the Pacific Northwest and the San Francisco Bay Area.

Business Sentiment

District respondents expect continued expansion of the national economy and their respective regional economies. Most respondents expect U.S. GDP to continue to grow at its long-run average pace of 2 to 2 ½ percent in 1997, leaving the national unemployment rate near its current level. A majority of respondents expect inflation to remain near the current rate this coming year, although some anticipate a slight pickup in inflation. With regard to regional conditions, over three-quarters of the respondents expect growth in their area to outpace national growth in the coming year, with business investment, housing starts, consumer spending, and foreign trade, all expected to post solid gains in most regions.

Retail Trade and Services

Respondents from most District states reported a high level of retail sales in recent

XII-2

months, despite the shortened holiday selling season. Although somewhat below original projections, holiday season sales compared with one year ago reportedly posted good gains in California, the Pacific Northwest, and the Intermountain states. Retailers faced reduced pressure to discount most items prior to Christmas, given the level of sales and relatively lean inventories going into the season. However, sales at electronics and computer specialty stores reportedly were lower than expected, leading to some aggressive discounting. Heavy snow in the Seattle area immediately after Christmas reportedly held down retail activity there near the end of the year.

Service industries generally reported further growth in recent months. Respondents from California and the Pacific Northwest reported increasing demand for telecommunications services, and efforts to keep up with this growing demand reportedly are putting upward pressure on wages of some types of skilled workers. In Southern California, port traffic was strong, and tourism activity was brisk. Tourism-related airport traffic and hotel occupancy rates also increased in several other states, including Utah, where pre-Olympic advertising increased downhill skiing business. However, heavy rains and flooding constrained tourism in Nevada and Northern California, largely due to highway and park closures.

Manufacturing

The manufacturing sector continued to expand in most areas of the District. Manufacturing growth was particularly strong in the Pacific Northwest, owing largely to the resurgence of the aerospace industry and expansions at manufacturers of high technology components and equipment. Wood product sales in the Pacific Northwest also were high, boosted by demand for materials to repair storm-damaged homes and businesses.

Agriculture and Resource Related Industries

District agriculture conditions have been mixed in recent months. Early rains and warm temperatures created favorable California grassland conditions, benefiting the range cattle industry and creating favorable conditions for the new planting season. However, declines in many agricultural commodity prices combined with increasing production costs reportedly have caused some farmers to delay purchases of new equipment and other discretionary inputs. Also, in Northern California and Nevada heavy rains and flooding damaged some crops in fields and orchards and forced ranchers to move livestock to higher, less attractive grazing areas.

Real Estate and Construction

Residential and commercial real estate markets continued to be strong in most areas of the District. In the Pacific Northwest and Intermountain states, strong demand for single-family residences has resulted in considerable home price appreciation, although the pace of gains in the Intermountain states slowed in recent months. In California, building in the state as a whole continued to be weak. Within California, San Francisco and Silicon Valley continued to outpace the rest of the state in the residential real estate market recovery with continued price appreciation for single-family homes and declining vacancy rates for rental properties. Southern California's housing market also showed signs of improvement in recent months, as home prices began to rise and sales increased.

Financial Institutions

District financial institutions generally reported that strong economic conditions continued to boost loan demand. Despite increasing consolidation of banks, the lending environment was said to remain highly competitive, both among banks and from non bank competitors.