SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICTS

January 1989

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SUMMARY*

Most District reports indicate somewhat stronger regional economic activity on balance in December and early January than at the time of the last reports in November, with much of the growth centered in the retail and industrial sectors. It would appear, on the basis of these reports, that the national economy gained momentum in recent weeks as consumer spending strengthened, manufacturing activity continued to rise, and producers scheduled more investment in plant and equipment.

Reports on activity outside of the retail and industrial sectors were mixed and showed little change from the levels of recent months. In banking, loan demand was generally flat. In construction, commercial and residential activity evidently remained subdued in most of the country, although some areas of strength were reported. In agriculture, the continuing dry weather in some areas threatened the winter wheat crop.

Although the overall tone of the District reports was upbeat, one District (Philadelphia) cited indications that the pace of activity may be slowing. Another (St. Louis) reported that growth was still sluggish even though conditions had improved in recent months.

Consumer Spending

Eleven of twelve Districts reported on consumer activity. All eleven indicated that retail sales in December met or exceeded retailers' expectations. Three Districts also observed that the moderate-to-strong pace

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of sales in December continued through early January. New cars sold well over this period, and truck sales were even stronger. Cleveland indicated that luxury goods such as electronic equipment and fine jewelry had sold especially well, which might indicate higher consumer confidence.

Increases in retail prices were reported as moderate by Boston and Minneapolis, and Kansas City found prices to be generally steady to slightly higher. San Francisco observed that apparel prices were still rising faster than the prices of most other items. Boston reported that wages for retail clerks were still rising briskly.

Manufacturing and Mining

All Districts reported on manufacturing activity, and most of the reports suggested that production levels were currently at or above November levels. San Francisco indicated expansion in the aerospace and electronics industries, and Boston noted strong demand for manufactured items used by the commercial aircraft and automobile industries and most capital goods industries. Dallas and Chicago noted increased demand for steel products, but Cleveland indicated a sharp slowdown in steel production, and reports from a few Districts stated that activity was down in some construction-related industries such as lumber.

Several industries were reported to be operating at high capacity utilization rates, but only a few, such as chemicals, claimed capacity limits had constrained production. A majority of Districts indicated that manufacturers plan to increase capital expenditures in 1989 over 1988 levels. Most of this spending will be for new equipment rather than plant expansion.

Labor market conditions in the manufacturing sector appear to be about the same as in November in most Districts. Factory labor was reported to be scarce in some areas. Boston indicated that producers expect wages to rise this year at about the same rate as last year. Cleveland noted moderate increases in wages. Cleveland and Atlanta mentioned significant increases in employee benefit costs. About 60 percent of the respondents to both the Philadelphia and Richmond surveys reported rising input prices. Boston indicated that the prices of some raw materials such as paper, wood, and most metals appeared to be stabilizing but that the prices of semi-finished goods such as petrochemicals were still rising.

Reports on mining were mixed. Minneapolis and San Francisco indicated strong activity in silver and copper mining, and San Francisco also noted strength in gold and phosphate mining. But oil drilling activity in the Dallas, Kansas City, and San Francisco Districts was apparently restrained because of uncertainty about future prices.

Construction

Reports on current nonresidential building activity varied widely across Districts, ranging from strong in Chicago and San Francisco to weak in St. Louis. Construction of industrial facilities was reported to be robust in some areas. Chicago indicated work on industrial buildings was very strong in the Midwest, and San Francisco mentioned new plants and continued expansion of manufacturing facilities in the West. Philadelphia, however, stated that despite a high demand for industrial space, "...construction of new industrial buildings may decline this year due to a pullback in lending to builders by financial institutions." Prospects for nonresidential building overall in 1989 appear to be relatively weak as new contracts declined in Chicago, Dallas, and St. Louis.

In the residential sector, housing contracts and starts declined in the Chicago and Kansas City Districts, which suggested a future slowing of homebuilding activity in those regions. Dallas, however, indicated some growth in permits for single-family homes, and San Francisco reported healthy homebuilding activity in some parts of its District.

Agriculture and Forestry

Six Districts commented on conditions in the agricultural sector and four of these--Richmond, St. Louis, Kansas City, and Dallas--reported concern about the impact of continued dry weather. Dallas noted that the winter wheat crop had already been damaged by drought, and Kansas City and St. Louis said that dry conditions threatened the wheat crop in their Districts.

Several Districts noted higher grain and livestock prices. While crop farmers have benefited, livestock farmers have been adversely affected to some extent because of higher feed costs. Kansas City noted that cattle operators in its District had not expanded herds, despite strong beef prices, because low moisture had reduced the use of winter wheat pastures for grazing.

Reports of a slowdown in lumber production were recorded by Atlanta, Dallas, and San Francisco, but Minneapolis characterized lumber output in its District as strong. The softening in domestic demand for lumber, which was attributed to sluggish homebuilding, was reportedly offset somewhat by increased foreign demand.

Banking

Loan demand varied among the Districts that reported on banking conditions. The demand for commercial and industrial loans was said to be weaker in the St. Louis District, largely unchanged in the Richmond and Kansas City Districts, and growing slowly in the Cleveland District. Philadelphia reported a strong increase in commercial and industrial loans so far in

January, but a reduction in inquiries and applications. Both Philadelphia and Richmond indicated continued healthy demand for consumer credit, but Cleveland and St. Louis noted slower growth.

FIRST DISTRICT-BOSTON

Economic activity in the First District continues at a moderate but healthy pace for manufacturers and retailers contacted in early January. Most manufacturers report that shipments and orders are above year-earlier levels, with exports contributing to their growth. Retail results were generally less robust than those in manufacturing, with sales flat to slightly higher. Price increases are modest. Capital expenditures planned for the region's stores and factories exceed 1988 levels.

Retail

First District retail contacts generally report sales during December and early January to be flat to moderately higher compared with year-ago levels. Most respondents are satisfied with these results, as retail business in the region stands at a very high level. A mild and snowless winter has dampened the movement of seasonal merchandise, but apparel retailers are heartened by good sales of spring fashions.

Several large chains report making significant and capital-intensive changes in the way they do business. These retailers are undertaking major refurbishments and opening additional outlets. They are also expanding their warehouse operations, further computerizing their business systems, and streamlining their administrative structures. Some firms plan major initiatives in 1989 while others intend to digest investments made in 1988. All retailers already embarked on these programs report significant gains in operating efficiency.

Prices are rising moderately according to most retailers in our survey. One firm reports the cost of sundries increasing 5 to 6 percent in 1988; another retailer indicates that previously declining prices are now flat. Wages for retail clerks continue rising briskly.

Manufacturing

All First District manufacturing contacts, except those in computer-related areas or serving the construction industry, report that shipments exceed year-earlier levels by at least 5 percent. New orders were generally even stronger - in some cases 30 percent above year-ago levels. The commercial aircraft, auto and most capital goods industries provided particularly good markets for First District manufactures. By contrast, most firms in or selling to the computer industry and firms supplying the construction industry report shipments and orders to be flat or down slightly from year-ago levels. Export orders generally continue to grow although the rate of increase has slowed in a few cases.

First District manufacturers report that prices for many raw materials, such as paper, wood, and most metals, may be stabilizing. But they see little slowing in price increases for semi-finished goods such as petrochemicals, specialty steel, motors and bearings. Contacts mentioned that the weak dollar had promoted exports of petrochemicals. With U.S. capacity limited, these exports contributed to rising prices. Most First District manufacturers have recently increased their own prices enough to cover part but not all of their rising materials costs. Exceptions are firms serving the auto, computer, and aircraft industries; these firms have not been able to increase prices.

Employment levels at most First District manufacturers are flat to down slightly. Only two firms mentioned a lack of skilled labor as a production constraint. Contacts expect wages to rise 4 to 5 percent in 1989 as they did in 1988.

First District manufacturers generally plan to increase capital expenditures from 1988 levels. Most will emphasize equipment rather than plant in 1989; only one-third of the respondents intend to build or expand plants. The emphasis on equipment is attributed to recently completed expansion programs and the fact that just-in-time inventory systems and simplified production procedures (leading to shorter assembly lines) have freed significant space. Only one firm suggested that uncertainty about foreign exchange rates is discouraging U.S. firms from building plants to serve the export market. Most respondents plan to include computers in their equipment purchases; however, two firms suggest their total spending on computers may slow as upgrading replaces expanded use.

All manufacturers contacted claim that they have adequate capacity overall, but one-third mentioned a product for which capacity has recently been a constraint. In general, respondents do not feel that U.S. capacity limits are curbing exports or supporting imports to any significant extent; a few mentioned imports of chips, bearings and VCRs as special cases. Most contacts believe that price and quality of product and support service are sustaining current imports.

All First District manufacturers express modest optimism about the coming year. While they all expect growth to slow (with real GNP forecast to rise 2.5 percent), they generally view this slowdown as a healthy development with favorable implications for inflation and interest rates. They remain concerned about the impact of take-over activity and the overall debt level on investment.

SECOND DISTRICT--NEW YORK

Developments in the Second District economy in recent weeks have varied among sectors, in part reflecting seasonal influences. Most retailers described Christmas holiday sales as on or above plan and a pickup in office leasing has occurred. Homebuilding is seasonally slow and in some overbuilt areas, developers are offering concessions. While the percentage of purchasing managers reporting improved business conditions showed about a normal seasonal decline, the proportion indicating worsened conditions was somewhat higher than usual. Small- and medium-sized banks have recently increased interest rates charged on their loans.

Consumer Spending

Most retailers contacted in the District described sales during the 1988 Christmas season as on or above plan. A major exception was a chain whose sales had been below year-earlier levels for several consecutive months. While sales results generally were as targeted, most stores reported relatively moderate over-the-year gains, given the extra shopping days this year. Increases mainly ranged from 2-10 percent.

Items in strong demand among holiday shoppers were electronic games, video cameras and recorders, appliances and men's clothing. Interest in women's apparel also improved, though the extent of the improvement varied. Inventory levels at the end of December also were mixed. One chain with lower than targeted inventories reported lost sales because of its having understocked several popular items. At the other extreme were two retailers with inventories well above plan, who expect to discount heavily throughout January in order to clear the remaining seasonal goods from their shelves.

Business Activity

The percentage of purchasing managers in western New York reporting improved business conditions showed roughly its usual decline for this time of year, but the proportion with worsened conditions was somewhat higher than usual. Among recent developments in the District, Grumman announced that it will eliminate 2500 jobs beginning in January as a result of the Pentagon's cancellation of a bomber project. Elsewhere, a recent groundbreaking gives further evidence of a turnaround in the South Bronx. A $100 million retail and office project is now underway on a long-vacant tract; it is to include a full service supermarket, the first new movie theater in the area in 15 years, a shopping mall and a new office building. Some 1500 permanent jobs are expected to be created.

With regard to the impact on the District of certain national developments, the newly proposed changes and closings at U. S. military bases are not expected to have an adverse effect on the District. Personnel from the Brooklyn Naval Station, which is slated for closing, will be moved to a new Staten Island facility. In addition, a New York State official recently stated that the newly signed U.S.-Canada Free Trade Agreement should be of benefit to much of western and northern New York. Finally, governors in each of the three District states reported substantial shortfalls in revenues and New York and New Jersey have imposed hiring freezes.

Residential Construction and Real Estate

Homebuilding activity in the District is seasonally slow, and in those parts of the New York metropolitan area where a buyer's market exists, developers are offering concessions. In Manhattan, however, where a rush of new apartment construction had begun prior to a November 1985 deadline to receive certain subsidies, most units have reportedly been sold without a glut developing as many had feared. Moderate-priced housing remains in demand in much of the District.

A pickup in office leasing has occurred in recent weeks. In downtown Manhattan a major brokerage firm leased 1.1 million square feet of space in a building at the World Trade Center which had been mostly vacant for a long time. Buildings going up on the west side of midtown Manhattan continue eliciting interest with the result that leasing there in 1988 was second only to 1987's record amount. Marine Midland Bank unveiled plans for a new office building in downtown Buffalo to house its backoffice operations, and work is also to begin soon on the second phase of New York City's conversion of the Brooklyn Army Terminal into industrial space for small manufacturers. The first phase, opened in late 1987, is 80 percent leased and negotiations for the remainder are underway.

Financial Developments

In response to the rise in the prime and other market rates, small- and medium-sized banks in the Second District survey have recently increased interest rates charged on their loans. Some increases were automatic as most commercial loans and many mortgage and consumer installment loans have floating rates tied to the prime. However, rates on fixed-rate loans have been raised as well. Most officers said their banks had not felt competitive pressures to resist the recent round of interest rate hikes because other local banks also raised their rates. Bankers reported that competition to offer depositors the most attractive rates on 3- and 6-month CDs has been keen. However, none of the surveyed banks have increased rates offered on savings accounts. Regarding the outlook, nearly all respondents expected additional modest increases in interest rates for the first half of 1989, though several thought rates may ease slightly by mid-year. When asked to judge the strength of their local economy, bankers' responses were mixed. About half described their local economy as moderately strong but with some weak sectors, such as real estate. The rest characterized their local economy as quite healthy.

THIRD DISTRICT - PHILADELPHIA

The Third District economy continues to expand as 1989 begins but there are indications that the pace of the advance may be slackening. Manufacturers polled for the January Business Outlook Survey report moderate improvement again this month, marking a full year of expansion according to the survey. Most retailers report meeting their Christmas sales goals of modest real growth from the previous year. Bankers indicate that loan growth was good as 1988 closed, with business, personal, and real estate lending all on the rise. Realtors describe the commercial real estate market as healthy but note a decline in residential sales since the summer.

While current conditions indicate continuing growth in most sectors of the Third District economy, slower progress may be ahead. Manufacturers expect activity to ease from its current pace during the first half of the year. Retailers are generally cautious in their sales planning for the new year and most are keeping inventories under tight control. Bankers note a falloff in business loan and mortgage applications in recent weeks, and they expect slower growth in all types of lending this year compared to last. Realtors expect commercial leasing activity in 1989 to run at around the same rate as in 1988. Although they are looking for a pickup in residential sales by spring, they say the prospect is uncertain.

MANUFACTURING

Local manufacturers are starting 1989 on a positive note, according to the January Business Outlook Survey, although they believe business might dip later in the year. Among firms participating in the survey, 36 percent report business is moving up while only 8 percent say it is slowing. In both the durable and nondurable goods sectors most measures of industrial activity reflect moderate expansion. New orders, shipments, and order backlogs were rising in January, and inventories were edging down. On balance, survey participants were increasing working hours and adding marginally to payrolls.

Industrial prices in the region remain on an upward trend. Sixty-one percent of the January survey participants said they were paying more for inputs compared to December and 38 percent were raising the prices of their own products.

In contrast to current reports of generally healthy business conditions, local manufacturers predict some decline in activity by midyear. Looking out six months, 27 percent of the January survey participants expect the pace of business to slow while only 18 percent expect further improvement. On balance, survey respondents foresee the rate of orders holding steady during the first half of the year while shipments rise slightly, leading to a decline in order backlogs as manufacturing activity slows. Despite this forecast, survey respondents are planning to add workers and boost capital spending between now and summer.

RETAIL

Third District merchants generally reported meeting sales goals for the Christmas season, helped by stronger than usual sales in the week after Christmas. Department stores in the region averaged around 6 percent year-over-year gains, in current dollar terms. Discount stores did somewhat better. Specialty store results were mixed: some posted strong increases while others only matched or fell below their 1987 performance. Most store officials said their inventories were lean as Christmas approached, and they did not make significant unplanned price reductions.

Most merchants contacted in early January described their sales plans for 1989 as very cautious. Their impression of consumer confidence is that it is high but fragile; and many retailers believe that sales could drop off sharply in the wake of any negative economic news.

Third District auto sales in early January were up from the same period last year for domestic makes, but off for imports. Dealers say demand for most U.S. models is running above expectations although a few are not proving popular and incentives are being offered to reduce inventories of these cars. Area dealers say total unit sales in 1988 were around 3 percent higher than in 1987, in contrast with forecasts of a slow year. Few dealers expect growth to continue in 1989, but most think sales will not fall substantially below the 1988 level.

FINANCE

Loan volume at major Third District banks in December was approximately 13 percent above the December 1987 level, reflecting a year-over-year growth rate that has been steady since mid-1988. Bankers contacted in January said the volume of commercial and industrial loans being booked was moving up strongly, but inquiries and applications from potential borrowers were dropping off. Consumer credit lending was increasing at a pace that bankers described as healthy but not exceptionally strong after accounting for seasonal variation. Real estate lending continues on a trend of strong but slackening growth.

Most area bankers expect that the pace of growth for all types of lending will ease as the year progresses. They base this forecast on estimates of slower economic growth nationwide.

REAL ESTATE

The commercial real estate market in the Third District is characterized as generally healthy by area real estate firms. The office vacancy rate in the central business district of Philadelphia is estimated at 14 percent currently, up only slightly from a year ago. The vacancy rate is projected to be stable in 1989 and then move up slightly as new buildings are completed in the next few years. Suburban office vacancy rates range from 16 to 25 percent, essentially unchanged from a year ago. Effective rent charges (rates minus the value of concessions and services provided by landlords) throughout the Third District are described as stable for older office buildings but rising somewhat for new buildings.

Demand for industrial buildings has been strong, coming mainly from area manufacturers who are expanding. Realtors say the supply of new space is tight; and they believe construction of new industrial buildings may decline this year due to a pullback in lending to builders by financial institutions.

Residential realtors say sales of existing homes have declined in many parts of the Third District since the summer, and price appreciation has slowed, as potential buyers are increasingly reluctant to pay current asking prices. Realtors expect sales activity to pick up gradually this spring as sellers begin to accept lesser gains than they had been anticipating on sales of their homes. Realtors do not view current mortgage rates as a deterrent to sales.

FOURTH DISTRICT - CLEVELAND

Summary

The Fourth District economy continued to post gains in most sectors. Increases were reported in production and new orders, while manufacturing employment has remained generally flat. Retail sales over the holiday season were better than expected, marked by brisk sales of luxury items and automotive products. Service jobs led recent employment gains, and unemployment rates hovered around the national average. Loan demand continued to increase at a moderate rate.

Retail Sales

Retailers in the District reported larger-than-expected sales gains in December. Many reported that sales were up by 8 to 10 percent from a year ago. Price markdowns were smaller and less widespread than usual, both because demand was strong and because merchants had kept their inventories quite lean. Luxury items, particularly electronic goods and fine jewelry, sold especially well, suggesting higher consumer confidence. Sales of small appliances were strong, and apparel sales seem to have recovered from their slump.

Local auto dealers reported that December sales were very good, particularly for light trucks and minivans. Sales were slow during the first week of January, after which they rose moderately. Inventories are considered to be sufficient, but there are shortages of the most popular models. Although manufacturers' buyer incentive plans are widely available, dealers say they are not an important contributor to sales. Financing is readily available, and rising interest rates have not yet increased monthly payments enough to deter buyers.

Labor Markets

The latest unemployment figures continue to show Pennsylvania at slightly below the national rate and Ohio at slightly above the national rate. Despite the relatively low unemployment rates, the average length of the workweek has remained constant and wage increases have been modest. However, many employers reported that benefit costs have risen significantly, driving up total compensation.

Since last year at this time, Ohio added 90,000 jobs, raising employment by about 2 percent while the number of workers unemployed fell by 12 percent. The picture is similar in Pennsylvania, where jobs rose by 60,000, increasing employment by 1 percent while decreasing unemployed workers by 17 percent. Although the labor market in these areas is generally strong, employers reported ample supplies of qualified workers.

Eastern Kentucky, on the other hand, continues to experience a weak labor market. For example, a recent automobile plant opening there drew fifteen times as many applicants as there were job slots.

Most of the new jobs in the District have come from the service sector, with business services continuing to show the largest increases. Manufacturing employment has been flat throughout most of Ohio, while Pittsburgh experienced its first annual increase in manufacturing employment in almost a decade.

Manufacturing

The Fourth District's manufacturing sector continues to expand. Purchasing managers reported increases in output and new orders. However, their production index dropped well below the survey average over the last two years, even when seasonal factors are considered. The slowdown in steel production contributed to the slower production rate. Steel production in the Youngstown, Pittsburgh, and Lake Erie steel districts fell 10.4 percent in the last four weeks over the previous four-week period. This decline is greater than the 2.3 percent decrease for the U.S. steel industry as a whole.

Price increases continue to be moderate. Only 41 percent of the respondents to the purchasing managers survey reported higher prices, which is the lowest percentage in over a year.

Commercial Banking

District loan demand has continued to be modest. Total loans outstanding at large banks grew at an annual rate of 4 percent from the beginning of November to the end of December. Lending to financial institutions and other businesses accounted for most of the credit growth. Commercial and industrial loans rose at an annual pace of 2 percent, about the same pace as in September and October. Loan rates have increased, and consumer installment and real estate loans outstanding have contracted somewhat in the last two months. Also, the pace of home equity lending has tapered off considerably with growth falling to the single-digit range.

FIFTH DISTRICT-RICHMOND

Overview

The District economy generally continued to grow at a moderate pace in December and early January, and in some regions--such as the Washington metropolitan area--growth was still very strong. Retail sales were stronger than in November, and department stores experienced a somewhat better Christmas season than a year ago. Manufacturing shipments rose again; other measures of producer activity were mixed. The demand for commercial and industrial loans stayed flat, while the demand for consumer credit remained relatively strong. Export activity increased at District ports, while import volume was largely unchanged. In the agricultural sector, below normal precipitation continued to be a concern. Most business, financial, and agricultural respondents were optimistic about prospects for their businesses and for the economy in general in 1989.

Consumer Spending

Responses to our regular survey of District retailers indicated that seasonally adjusted retail sales during the first half of January were above those of the last half of December and those reported in November. Almost half of the respondents to this month's survey reported increased sales while about 40 percent reported declines. In contrast, November reports of declines were about equal to reports of increases. Most automobile dealers reported increased sales during the first three weeks after Christmas, and almost half of the department stores reported increases. Three-fourths of the retailers expect sales to increase in the next six months.

Christmas sales were reported to be somewhat stronger than last year by department stores in the District. Over half of the respondents said their sales were higher than a year ago, while 15 percent said their sales were lower. Most respondents said merchandise markdowns during the Christmas season were about the same as usual.

Manufacturing

District manufacturing activity was mixed in mid-January compared to a month earlier according to our regular mail survey. About half of the survey respondents indicated no change in their activity. Among those reporting changes, reports of increases in shipments and new orders outnumbered reports of declines, but reports of declines in backlogs of orders exceeded reports of increases. The length of the workweek and the level of employment were generally unchanged; labor was reported to be scarce in some areas. As compared with our previous survey of manufacturers in mid-November, our most recent survey indicated a slightly slower expansion in producer activity. Reports of higher prices of materials were made by about 60 percent of the respondents--slightly above the percentage reporting increases in our November survey.

Among manufacturers who export, about half said their export volume was flat in 1988, while about 45 percent reported increases. Only two respondents, both textile producers, indicated declines in their exports. Looking ahead, about three out of every five respondents expect increases in their exports in 1989 over 1988. Only one respondent expects his firm's exports to decline.

In this latest survey, more District manufacturers were optimistic than in our previous survey. Forty-nine percent of the January survey respondents expect their shipments to rise in the next six months and 15 percent expect declines, compared to 34 and 26 percent, respectively, in November. In the January survey, respondents expecting increases in each category of manufacturing activity--new orders, shipments, backlogs of orders, employment, and the workweek--outnumbered those expecting declines.

Ports

Representatives from the three major District ports--Baltimore, Charleston, and Hampton Roads(Norfolk)--noted increases in exports in December compared to November. Imports were apparently steady, with shipments reported to be only slightly higher at Hampton Roads and unchanged at Charleston and Baltimore. Strong increases in export activity are expected at the two largest District ports over the next six months; the port of Charleston expects export activity to remain about the same. When asked to compare their current activity to that of a year ago, all port representatives indicated that their export activity was growing faster than their import activity.

Financial

The majority of Fifth District bankers responding to our telephone survey reported that demand for commercial and industrial loans, particularly commercial construction loans, had been relatively flat in recent weeks. However, roughly two-thirds of the respondents characterized the demand for consumer credit as relatively strong. The bankers contacted held divergent expectations of loan activity in 1989, but several indicated that they expected reduced lending activity. Their assessments of the national economic outlook were also mixed, and several respondents emphasized that the economy's course will depend on future fiscal policy. Only one respondent expects a recession in 1989. A large majority expect a further rise in interest rates through mid-year, followed by a leveling off and then a decline in rates during the second half of 1989.

Agriculture

Although rainfall in most of the District was about normal from September through November, a relatively dry December left pond and stream levels lower than normal. Our contacts were optimistic that grain prices would strengthen in 1989. One large poultry producer expressed concern that low stocks of corn and the resumption of exports to the U.S.S.R. could drive feed costs even higher in the coming months.

SIXTH DISTRICT - ATLANTA

The southeastern economy (especially the manufacturing sector) continues to perform well, in part due to expanding exports. Most respondents are optimistic about prospects for 1989 and project capital spending to be at or above the 1988 pace. Although a majority of producers polled do not anticipate serious shortages or particularly large price increases this year, it promises to be a close call in some regional industries, for example primary metals and paper. Overall, added capacity in the region is expected to reduce supply bottlenecks that emerged last year.

Announcements of price increases were fairly widespread in December. However, that is normally the time when suppliers post higher prices for the year ahead. At this point, respondents expect that some of these will be trimmed or deferred because of buyer resistance. With modest additions to capacity during the latter half of 1988, expectations of product price increases in 1989 are below the pace seen in 1988 and range between 3 and 5 percent. Despite import quotas on many products and higher import prices, foreign competition is still reported to be an important limitation on price increases. Several contacts remarked that some important labor contracts are up for renewal; they expect wage increases in 1989 to turn out between 4 and 6 percent. Many report that double digit increases in employee medical insurance are adding significantly to labor costs.

By and large, growth in exports of regional industries does not appear to have been affected by capacity constraints and there are few reports of delivery lags in meeting export orders. In many instances strong global markets have served to offset a slackening in domestic demand. At the same time, import levels have been unusually high in a few industries facing bottlenecks in production. New capacity coming on stream in 1989 is expected to increase domestic supplies and lower the general level of imports.

Some southeastern industries such as home appliance and lumber manufacturers are projecting slower growth in 1989 as a result of the flatness in homebuilding. Inventory adjustments at the retail level caused some Tennessee sawmills and furniture plants to schedule two weeks of shutdown in December. Lumber company salesmen commented that volume lumber purchasers have become more conservative. Weak domestic demand for lumber is being partially offset by strong foreign demand as rebuilding efforts in Iraq and in the Caribbean are using significant amounts of lumber. There are reports of higher input prices for selected items such as steel and plastic in the appliance industry. Because of weakness in domestic purchases and competitive pricing, they have not been able to pass along the full increase in raw material prices.

The aluminum industry is running at high capacity levels and producers report increases in input (aluminum ingot) prices of about 60 percent since a year ago. New orders are tapering off slightly as higher input prices have been passed through to finished products. Thus, no further price increases are planned in the near future. Delays in deliveries have been limited to scrap aluminum, which was diverted to export markets as world prices rose. Producers remain optimistic about prospects for 1989 and the industry is expanding. A new plant is coming on line in Georgia and an Alabama manufacturer is undergoing major capacity expansion.

Paper mills have experienced especially strong demand, although there are signs of easing compared with the first half of 1988. Orders are higher in selected grades such as coated paper and some types of paperboard. Capacity constraints on domestic shipments of these grades have kept imports higher than they otherwise would have been. Several producers of linerboard announced price increases of up to 10 percent. Capital spending in 1989 is projected to be slightly above the 1988 level, which was up a sharp 25 percent. Additions to capacity are primarily in the form of new machinery or extra shifts of workers to make heavier use of existing equipment.

Production capacity poses an important constraint on growth in chemicals. New orders for basic chemicals continue to be strong and tight supplies of ethylene have meant higher imports (despite sharply higher prices). The global market for specialty chemicals going into plastics and paper is experiencing robust growth. When questioned about marketing efforts, one source remarked "its been more a game of getting the pounds out rather than worrying about product differentiation". Polyethylene sales are being eroded by cheaper, competing polymers.

Although demand for agricultural chemicals is said to be seasonally low, increased 1989 planting expectations and strong export markets have strengthened the outlook. A previously idle agricultural chemicals plant in Louisiana was opened in December.

Trucking transportation should experience increased activity this year. Frozen foods and dry goods carriers appear to be doing best. Some carriers are facing a shortage of drivers. While labor costs or wage gains are reported as moderate, high and rapidly escalating insurance premiums are placing pressures on costs. These cost pressures are expected to lead to increases in freight rates in 1989.

Apparel and textile companies are taking a cautious outlook for the new year. A large apparel manufacturer plans to keep inventories lean and reduce domestic production by outsourcing to low-wage countries. Textile firms report solid orders for bed and bath products but apparel producers are reluctant to create a new fashion direction because of the industry's uncertainty as to the direction of the economy. One spokesman warns that imports could surge during 1989 as a result of 1988's market weakness which left importers with unused quotas that can be carried forward to the new year.

SEVENTH DISTRICT--CHICAGO

Summary. Business activity continues to expand in the Seventh District. The Christmas shopping season was stronger than expected for many retailers. Paperboard shipments have picked up, after growing more slowly in the second and third quarters. Demand for steel continues strong. Motor vehicle production plans are at high levels, but some contacts expect slower sales in 1989 to require cutbacks. Demand for equipment is robust across a range of industries, but one contact notes increased hesitancy about further additions to capacity, out of concern that the economy may turn down in 1990. Construction activity has been above expectations, but advance indicators suggest that declines are likely. Some labor markets have tightened in recent years, but conditions vary widely among locations and occupations. Farm debt owed to banks rose last year, after declines in previous years.

Retail Sales. Merchants report generally favorable results for the Christmas selling season. An Illinois retailers' group estimates that its members' sales during the period were 6% or more above a year earlier. Many engaged in less promotional activity than in recent years. The picture is mixed, however; year-to-year sales gains at a large general merchandiser's Chicago-area stores were relatively weak compared with other parts of the country. Where sales were up, strength was in both durables and nondurables, including women's apparel. The pickup in apparel is expected to continue. Credit sales are high. Contacts have indicated that delinquencies have risen but not alarmingly.

Labor Markets. Markets for labor have tightened in the District over the past few years, but conditions differ substantially among geographic areas and occupations. A manufacturer planning additions to employment foresaw problems finding qualified factory workers at a plant in a "booming" Chicago suburb, but not at other plants. Stores in large shopping centers around Chicago reported difficulty finding clerical staff, particularly through the Christmas season. Fast food restaurants advertise continuously and prominently for employees. Some skills are in short supply. On the other hand, openings for other skilled and experienced workers appear quite limited, attributed partly to corporate downsizing and mergers. An outplacement firm reports a sharp rise, during the past 2 years, in the proportion of people willing to relocate out of state.

Steel. Orders for steel are strong but "orderly," with lead times shorter than at seasonal peaks last spring. Demand from auto and appliance makers continues at high levels. Sales to industrial equipment makers remain well above levels of a few years ago. Adequate capacity for these types of steel is in place for further expansion. Construction steel markets are strong, and the largest backlog in years will keep shipments brisk at least through the first half of 1989. Steel service centers' sales continue vigorous.

Motor Vehicles. Industry observers think auto production plans may be excessive relative to likely sales. Inventory accumulation would lead to enhanced sales incentives, production cuts, or both. One source forecast a 2% decline in unit auto sales in 1989. Another expected a drop of 5% or more. Truck sales in 1989 were expected to be near all-time highs, but down a little from 1988's record pace. A heavy truck maker predicted continued strong demand for large trucks in early 1989, but thought a weaker economy and higher interest rates may subsequently cut into sales.

Equipment. Reports on the outlook for business equipment are mixed. The producers' durable goods sector continues to "roll on with great momentum," according to one source. Another expects capital spending programs begun in 1988 to keep investment vigorous in 1989. Strongest have been chemical process industries. Other industries reported to be adding to capacity include manufacturers of glass, appliances, tires, and some types of electrical equipment, as well as food processors, printers and airlines. Farm equipment sales may rise 15% to 20% this year, according to one producer.

Buying of construction and mining equipment was up strongly last year, but an industry source thinks the replacement cycle in these sectors may be nearly over. Another contact reports increasing concerns about the risk of economic weakness in 1990 may result in smaller spending increases than indicated by recent national surveys. A maker of communications equipment and electronic components sees indications of slowing in both sectors, and expects the downtrend to continue.

Construction. Declines in contracts for residential and nonresidential building construction in the 5 District states point to a slowdown ahead. However, suppliers indicate that the current pace of building activity remains fairly high. Work on industrial buildings is particularly strong in the Midwest. Work on hospitals, convention centers, and office buildings is also described as strong. Gypsum board shipments to District states rose somewhat in 1988 (based on 11 months of data) and are expected to be about even in 1989. (In view of the strength of construction material shipments to building sites and of construction industry employment, two contacts regard Commerce Dept. figures on nonresidential construction activity nationwide in 1988 as too low, particularly for industrial buildings.)

Agriculture. Farm debt owed to banks turned up modestly in 1988, following a 16% slide over three years in District states and a 13% decline nationwide. Call Report data as of the end of the third quarter show that farm debt owed to banks was up 3.4% from a year ago in District states, and up 3.0% nationwide. The gains stem from continued strong growth in farm real estate loans and, for the first time in 15 quarters, a nominal rise in farm production loans. Farm debt owed to other lenders continued to decline through the third quarter, but at a much slower pace than in recent years. About a year ago, banks moved ahead of the Farm Credit System as the largest institutional lender serving farmers.

EIGHTH DISTRICT - ST. LOUIS

Summary

Economic conditions in the Eighth District improved in recent months, but growth remains sluggish. Employment rose slightly, following several months of stagnation. Despite high capacity utilization rates that are expected to limit sales, capital spending plans of District manufacturers were mixed. Consumer spending during November and December was moderately strong. Overall loan activity was weak in the fourth quarter of 1988, particularly in the commercial area.

Employment

District payroll employment rose at a 1.3 percent annual rate in the three months through November, following six months of flat employment growth. A majority of the new jobs were in the services, trades and manufacturing sectors. District manufacturing employment also rose at a 1.3 percent annual rate during the September-November period, with the strongest growth in the printing and publishing and transportation equipment sectors. Compared with a year earlier, District payroll employment rose 1.5 percent, a substantially smaller gain than the nation's 3.6 percent increase.

November employment in the St. Louis area was 1.3 percent higher than a year earlier. Manufacturing jobs constituted almost half of the additional jobs. An auto assembly plant and a military aircraft producer each added approximately 2,000 workers over the year. Most new nonmanufacturing jobs were in services, wholesale and retail trade and transportation. The number of construction jobs fell substantially.

Capital Spending

Approximately one-quarter of the 24 District manufacturers recently surveyed indicated that sales in 1989 will be constrained by a lack of production capacity. The manufacturers were divided equally among those planning an increase in capital spending in 1989, those planning a decrease and those planning no change. Industries planning to increase spending included those producing food products, paper, rubber and glass products, metals and metal products. Industries producing textiles, clothing, chemicals, and transportation equipment anticipated reduced capital expenditures. Among all respondents, modernization and upgrading of existing plant and equipment were the most frequently cited forms of investment. Few indicated that capital spending would take the form of new plant construction. Only a few respondents felt that imports were increasing because of limited domestic capacity.

Construction

District construction activity declined sharply in recent months and was substantially weaker than a year earlier. The real value of District building contracts awarded in the three months through November was down 11.4 percent from the previous three-month period and down 10.9 percent from a year earlier. Both residential and nonresidential building have declined.

Consumer Spending

Before adjusting for inflation, District sales of general merchandise during the holiday season were approximately 6 to 7 percent higher than a year earlier. Most retailers from St. Louis, Louisville and Memphis reported moderate to strong sales gains. Reports from Little Rock were mixed, with several respondents reporting declines.

Almost all respondents were satisfied with their inventory levels, which were generally leaner than those of a year ago. Consequently, they engaged in less unplanned price-cutting and anticipate higher profits than last year. Women's apparel and consumer electronics were among the strongest selling products.

Most St. Louis respondents expressed more difficulty finding temporary Christmas help than in past years, but few raised wages. The availability of temporary help was also a problem facing some respondents in Memphis and Louisville but not those in Little Rock.

Banking

Total loans at large weekly reporting District banks grew at a 0.2 percent annual rate for the fourth quarter of 1988 compared with an 8.7 percent rate for the same period in 1987. Commercial loans, in particular, contributed to the overall slow growth, declining at a 5.8 percent rate; for the same quarter in 1987, commercial loan growth increased at a 12.4 percent rate. Consumer loans also decreased during the fourth quarter of last year, declining at a 2.7 percent rate. Real estate loans, which grew at an 18.6 percent rate, were the only loans reporting growth during the period.

Agriculture

Low water has repeatedly closed the Mississippi River to barge traffic this winter. Recent rains, however, have allowed the seasonally light traffic to resume. Despite recent moisture, soils in northern Missouri remain critically dry, making water for livestock scarce and harming the winter wheat crop.

NINTH DISTRICT--MINNEAPOLIS

Ninth District economic conditions have been fairly good. Unemployment rates increased over previous months but were generally lower than a year ago. Consumer spending, particularly Christmas purchases, was excellent. Price increases in consumer goods were moderate but some agricultural and raw material prices rose sharply. Conditions in resource-related industries were excellent.

Labor Markets

The employment situation has been fairly good throughout the district. Between October and November, Minnesota's unemployment rate rose eight-tenths of a percentage point to 4.5 percent. However this figure, like that for the other states reported here, is not seasonally adjusted and is substantially lower than the unemployment rate of 5.2 percent in November 1987. The unemployment rate in the Minneapolis-St. Paul metropolitan area rose by six-tenths of a percentage point from October to a rate of 4.0 percent in November. Analysts attributed this increase largely to seasonal factors. A director notes that high technology firms are experiencing tight labor markets of professionals, such as engineers. South Dakota's unemployment rate in November was 4.3 percent; eight-tenths of a percentage point lower than a year ago. North Dakota's unemployment rate was 5.2 percent in November, compared to 4.0 percent in October and 4.5 percent in November 1987. Montana's unemployment rate in October was 5.0 percent, up two-tenths of a percent from September. In the Upper Peninsula of Michigan, the unemployment rate was 6.7 percent in October, down five-tenths of a percentage point from October 1987.

Consumer Spending

Consumer spending on general merchandise has continued to increase and retailers report good to excellent Christmas sales. One retailer reports that sales in December were up 18 percent in comparable stores from December 1987 and that sales for all of 1988 were up 18 to 20 percent from the previous year. Inventories have stayed at acceptable levels.

Motor vehicles have been selling fairly well. Dealers for a domestic manufacturer estimate that their car sales for the entire year were up 5 to 7 percent from the previous year; however, dealers for another manufacturer report a decline of 3 percent in car sales in 1988 compared to 1987. Trucks have been selling extremely well, with dealers for one manufacturer reporting a 16.4 percent increase in sales in 1988 from the previous year. Dealers for another manufacturer report backlogs in truck orders of 8 to 10 weeks with even longer delays for trucks equipped with automatic transmissions.

Housing activity has been generally lower than a year ago. The number of new housing permits issued in Minnesota in November was 11.6 percent lower than in October and 15.1 percent lower than a year ago. Home sales in the Minneapolis-St. Paul metropolitan area for the year through November were 8.79 percent lower than a year ago. A director reports that the number of homes listed for sale in Montana for the year through October was 7 percent lower than in the same period a year ago.

Tourist spending has continued to be strong. The number of hotel reservations in Montana for December was reported to be 10 percent higher than a year ago and motels in Montana reported that their reservations for the year through October were 12 percent higher than the same period a year earlier. Ski resorts throughout the district also reported strong business.

Prices

Prices in the district have been increasing moderately in consumer goods and sharply in agriculture and raw materials. A director notes a near doubling of hay prices from a year ago. The value of farmland was reported to have stabilized.

Resource-Related Industries

Conditions have been excellent in the resource-related industries. New silver and copper mines are opening up in Montana. An aluminum reduction plant in Montana reports that all its production is guaranteed for sale through 1995. Several mining and processing firms in the same state have paid substantial year-end bonuses to their employees; in one case the bonuses are reported to be 106 percent of the employees' annual salary. The wood products industry in Montana reports having its best year ever. Several new mills are on the drawing boards or in construction. The Upper Peninsula of Michigan also reports an excellent year in the lumber industry.

TENTH DISTRICT - KANSAS CITY

Overview. The Tenth District economy continues to grow slowly. Retail sales have strengthened, as have new car sales. Manufacturers report high capacity use rates and some labor shortages. Demand for capital goods is still increasing. Farm incomes are at a high level, and that sector's financial recovery continues. Housing activity is weak, however, and the energy sector shows little change. Loan demand at commercial banks has changed little, while deposits have grown slightly.

Retail Sales. All respondents note that retail sales have improved from a year earlier, and most report that Christmas sales expectations were met or exceeded. Promotional activities have now returned to normal post-holiday levels. Sales of sportswear and accessories are relatively strong; sales of home furnishings are relatively weak. Prices are generally steady to slightly higher with some retailers reporting adjustments to wholesale price increases. Retailers' expectations are optimistic and inventory levels are generally satisfactory.

Automobile Sales. Most respondents report steady to slightly higher automobile sales over the last month. Adequate dealer and consumer financing is generally available. Most dealers report that they have sold most of the 1988 model cars, but some report higher than desired inventory levels. In general, dealers are optimistic about the outlook for automobile sales during 1989.

Manufacturing. Respondents are reporting moderate increases in major input prices compared with last year. Input prices are expected to level off in the months ahead, with some materials prices expected to fall somewhat. Firms are not experiencing difficulty getting materials, with some lead times shortening and availability a little better than a year ago. Most respondents are satisfied with inventory levels, but a few plan to trim inventories. Firms are operating at high levels of capacity use, with some shortages of labor, both skilled and unskilled.

Demand for capital goods is still increasing, on balance, among Tenth District manufacturers, although a sizable minority of respondents report some slowing. Nearly all respondents directed their 1988 capital spending toward equipment purchases rather than new plant construction, a mix that is expected to continue in 1989. Capital spending in 1988 did increase capacity slightly, however, through replacing obsolete equipment with more productive equipment, acquiring additional equipment, and adding shifts.

The majority of respondents export some of their output, and they report stable to increasing exports, which are unhampered by capacity constraints. Firms generally believe they can easily switch from producing for domestic customers to producing for foreign customers. Most respondents import some of their capital goods, but few have been increasing those imports. Uncertainty about changes in the value of the dollar is not an important consideration in capital spending decisions.

Energy. The district's energy industry remains stable following OPEC's recent agreement to restrict output. Although oil prices have firmed recently, uncertainty about the agreement's longer term effect on oil prices has held down drilling activity. December drilling activity was down over a fourth from a year ago, but the average number of active drilling rigs in the district rose slightly from 263 in November to 270 in December.

Housing Activity and Finance. Housing activity in the district remains weak. Homebuilders report that housing starts were down in December 1988 compared to December 1987 and were generally unchanged from November 1988. Single-family construction continues to be the strongest component, while multi-family construction remains weak. New home prices are reported somewhat higher, and the recent high level of home inventories is returning to normal.

Respondents from district savings and loan institutions report mixed savings inflow performance relative both to a year ago and to a month ago. Expectations of future savings inflows are also mixed. Promotional activity and a "flight to quality" from troubled institutions are largely credited for improvements in savings inflows at some institutions. Mortgage demand has been constant or down slightly in recent months. Mortgage interest rates have generally increased and are expected to increase further in the coming months.

Banking. District commercial banks report little change in loan demand over the past month. Demand for commercial and industrial loans and consumer loans was up slightly at a few institutions, while demand for most other types of loans was either constant or down slightly. About half of the respondents increased their prime rates by fifty basis points; most of the others had raised their rates earlier. Most of the respondents expect further increases in the near term. Consumer loan rates increased at most of the banks surveyed, and, again, most banks expect additional increases. Deposits increased somewhat at district banks, with the greatest strength in demand deposits, NOW accounts, and small time deposits.

Agriculture. Although the 1988 drought was generally not as severe in the Tenth District as in other parts of the nation, the moisture situation and crop conditions remain a concern in 1989. Several district areas have experienced very dry conditions through fall and early winter, and moisture is needed soon to ensure a healthy winter wheat crop in 1989. Soil moisture reserves are being further depleted by dry weather, which will make 1989 crops especially dependent on timely rains during the growing season.

Strong crop and livestock prices produced relatively high farm income in the Tenth District in 1988. As a result, year-end loan repayment rates were generally high, continuing the financial recovery begun in 1987. Most bankers in the region expect fewer credit renewals in the coming spring credit season as some farmers pay off operating loans and reduce carryover debt.

Changes in federal farm programs may have only a small effect on the financial situation of district farmers. Reduced acreage idling requirements may boost loan demand as farmers put land back into crop production. Fewer acres may be farmed in some areas of the district, however, as more acres are placed in the Conservation Reserve Program, trimming operating credit needs.

While strong livestock prices have contributed significantly to high farm income, little expansion has taken place in district livestock operations. Cow/calf operators appear to be just maintaining herds, holding back replacement heifers while selling cows. Inadequate wheat pastures have forced some stocker operations to reduce herds or purchase additional feed.

ELEVENTH DISTRICT--DALLAS

The District is growing moderately, chiefly as a result of expansion in manufacturing and in services. December retail sales were up at a healthy pace and auto sales have also shown some strengthening. Construction activity has changed little in recent months, but oil and gas drilling has entered another period of protracted decline. Continuing District drought problems, in contrast to improving moisture conditions nationally, suggest diminished net farm income prospects for 1989.

Manufacturing expansion is moderate overall, but variation among industries is great. Chemical producers say orders have been rising steadily this year, but there has been some seasonal slackening of late. Although some respondents in this industry express concerns over possible demand slippage in late 1989 or early 1990, reports of capacity constraints and of investments in plant and equipment are widespread. While a number of petroleum refiners are also running at full capacity, investments in plant and equipment beyond normal maintenance are not generally under consideration. Paper producers are undergoing a seasonal decline in demand, but most expect to operate at full capacity in 1989, as they have during 1988. Several said they plan capacity expansions this year. Steel manufacturers report increasing demand, except for construction-related products, and firms are optimistic about sales growth in 1989. Orders to fabricated metals manufacturers have been expanding throughout this year. Complaints about rising prices for steel inputs were common in this industry. Respondents in the construction-linked industries of lumber and wood products and stone, clay, and glass generally report continued weak sales and some say they are laying off workers. Electronics manufacturers note that demand has changed little overall in recent months. Most manufacturers say there are few, if any, upward wage pressures.

December retail sales growth varied across the District, but expansion was widespread. Houston's sales for the period were reported as up 6 to 7 percent from a year earlier, and Dallas' increases were said to be in the 7 percent range. A combination of a pegged peso, rising consumer prices in Mexico, and concerns over a possible devaluation was said to have pushed up sales by as much as 30 percent from a year earlier at some border retail establishments. Elsewhere, however, growth was said to be somewhat slower, with particular sluggishness in Austin.

New automobile sales in December rose above a year earlier and they were up markedly from the levels of November 1988. For the year, unit sales were up by 8 percent in Houston but up by only 2 to 3 percent in Dallas. Auto dealers expect significant increases in unit sales in the coming year but stress that volume is still below levels prior to the 1986 District economic downturn.

After growing moderately from April to August, the overall value of District construction contracts has changed little in recent months. Recent values remain at about half the levels of the third quarter of 1983. Despite the stability in overall contract values, there has been much change in the three principal components of spending. Nonresidential building contract values have turned down recently, while nonbuilding contracts have risen. Residential contract values have shown little recent change, but residential building permits have begun to grow, mainly through an upturn in single-family permits.

District oil and gas drilling has been declining lately and, in December, fell to its lowest level in more than two years. The principal leading indicators of drilling activity, including the seismic crew count and well permits issued, have also fallen. These reductions have occurred in the face of rising oil prices, which in December reached their highest levels since last April. Concerns are widespread that recent oil prices will not persist. West Texas Intermediate crude oil prices are generally believed likely to average about $15 per barrel this year. The current price of over $17 per barrel is not felt to be sustainable.

District agriculture continues to suffer from drought. According to early reports, moisture shortages have already damaged the District's winter wheat crop, most of which is in north and northwestern Texas. South Texas farmers are expressing renewed concern about the impact of dry conditions upon crops they will plant this winter. Over the last year, increased grain prices have squeezed profit margins of feeder cattle operations, whose product prices have risen less than the cost of feed. In December, however, beef cattle prices rose while prices of traditional feed grains fell slightly or remained unchanged from November. On average, prices received by Texas farmers and ranchers in December were unchanged from November but were 4 percent above a year earlier.

TWELFTH DISTRICT -- SAN FRANCISCO

Summary

The economy of the Twelfth Federal Reserve District continues to exhibit strength. Most respondents to the survey expect robust growth in their industries and regions, although they have become more pessimistic about the national economy. Resource industries remain healthy, with strong growth reported in mining. Construction is healthy in areas other than Alaska, Arizona, and Utah where real estate remains in oversupply. Manufacturing is expanding in most areas, led by aerospace, forest products, and electronics. Retail sales posted healthy year-over-year gains.

Business Sentiment

Respondents to the survey are more pessimistic about future national growth, investment, foreign trade, and inflation than they have been at any time during the past year. Nearly 64 percent of the respondents expect growth to slow, and 6 percent of the respondents anticipate a recession during the next four quarters.

These sentiments about national trends contrast sharply with the respondents' own industry and area outlooks. Despite the negative outlook for the national economy, respondents generally report very strong conditions in their regions.

Resource Industries

Respondents to the survey are optimistic about the District's agriculture. Recent rainfall has been near normal, raising hopes that the drought is ending in the West. High cattle prices are expected to keep profits high in cattle production despite rising production costs.

Agricultural exports from the District are expected to climb this year. One respondent in the Northwest reports very strong export activity for processed food to the Pacific Rim countries. Foreign demand is growing for agricultural products as tariff barriers are reduced. Some concern is registered in California, where a threatened tariff war with the European Community could reduce California's exports of walnuts and dried fruits.

Mining is very strong in the District. Respondents report substantial new investment to open new gold, silver, copper, and phosphate mines and to refurbish existing mines. Exports of copper are being eliminated by rising domestic consumption. Energy industries are being bouyed by rising oil prices, although most new expenditures on plant and equipment are designed to refurbish existing fields, rather than to discover new reserves.

Respondents in forest products industries report some easing of capacity constraints as demand growth slows and new capacity comes on stream. Production of plywood and lumber has fallen by 3 percent, but pulp and paper production remains near capacity. One respondent reports that log inventories have been rebuilt, but another respondent reports that small mills are unable to compete with Asian customers for logs and may be forced to close.

Construction and Real Estate

Real estate and construction are reported strong in the District, except in Alaska, Arizona, and Utah. Respondents in California report continued year-over-year increases in property values and sales activities. Nonresidential and residential construction remain at high levels in Southern California, and commercial rents are rising. The volume of residential sales is reported to be very strong in Oregon. A respondent in Seattle notes that housing prices are increasing at a 10 percent annual rate. Arizona remains over-built. Although home prices have not changed significantly, one respondent reports that the price of undeveloped land purchased in earlier speculative buying has fallen by as much as a 40 percent.

Manufacturing

Manufacturing industries continue to expand in the West. Boeing is building new plants in the Seattle and Spokane areas and is seeking to boost production by one plane per month at existing facilities. Capital equipment producers have become increasingly competitive in world markets. Several respondents reported that domestic equipment has been displacing foreign equipment. Caterpillar is said to be near capacity, with one dealer in Utah reporting a 30 percent increase in Caterpillar sales this year. Small electric power producers in the Northwest plan significant additions to capacity this next year. One respondent noted that the drought and increased consumption forced utilities to draw on reserve capacity this past year, signaling a need for new power production. One retailer reports a shift of apparel manufacturing to west coast cities from Asia because of higher imported apparel costs.

Electronics firms also are expanding. Several major electronics firms are building new plants in Idaho and other parts of the West. In California, however, sluggish sales of some electronic components have caused scattered layoffs.

Retail Sales

Retailers in the District report strong sales. Sales over the Christmas holidays ran 7 to 15 percent above year-earlier levels in most areas. Early indications for January show no slackening in consumer spending. Apparel prices have been rising faster than the general rate of inflation, and this trend is expected to continue through the first half of 1989.