March 5, 2003

Summary of Commentary on Current Economic Conditions by Federal Reserve District

Summary

Prepared at the Federal Reserve Bank of Chicago based on information collected before February 24, 2003. 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.

Reports from the twelve Federal Reserve Districts generally suggested that growth in economic activity remained subdued in January and February. Only a few Districts reported any notable changes from the last Beige Book. In particular, Richmond indicated that economic activity "grew modestly" and Kansas City noted "some signs of strengthening;" by contrast, New York said that the regional economy had "generally weakened." Many reports indicated that geopolitical and economic uncertainties were constraining consumer and business spending and tempering near-term expectations.

Consumer spending remained weak, on balance, with a few Districts noting a little improvement and others indicating a slight deterioration. Business spending was very soft, with little change in capital spending or hiring plans. Nearly all Districts indicated that real estate and construction activities were mixed, with strength on the residential side and weakness on the nonresidential side. Most Districts still described manufacturing activity as weak or lackluster, although half of the reports noted at least some degree of improvement. Refinancing activity continued to drive growth in household loans, while business loan demand remained weak. Contacts in most Districts expressed concern over rising energy and insurance costs, but noted that businesses had difficulty passing along much, if any, of the cost increases to their customers. The agricultural sector continued to be affected by poor weather in many Districts. Mining and energy extraction activity picked up, but energy production was limited by supply problems and some shortages of skilled labor.

Consumer Spending and Tourism

Overall consumer spending remained weak during January and February. Retail sales were generally flat throughout much of the country in January. Boston, Chicago, and Kansas City reported some signs of improvement during February, but severe winter weather over the Presidents Day weekend hampered shopping in the New York, Philadelphia, and Richmond Districts. Apparel sales were mostly weak, although discounting helped move merchandise in some areas. Reports on home furnishings were mixed. Valentine's Day merchandise sold well in a few Districts, and terrorism fears boosted the sales of duct tape, plastic, and other hardware goods in some regions. Retail inventories were generally low and in line with both current sales and merchants' conservative near-term expectations. New light-vehicle sales were down from year-end 2002 levels; new vehicle inventories were high for some product lines, and incentives remained elevated. Tourism and travel reports were mostly favorable. Richmond said that tourist activity strengthened. Atlanta reported a gradual improvement in overall tourism and continued strength in cruise activity through Florida ports. Kansas City noted that traffic to Rocky Mountain ski resorts remained solid. San Francisco reported that domestic and international travel to Hawaii improved, but was below expectations.

Business Spending

Business spending remained very soft, as geopolitical concerns and uncertainty over the strength of demand continued to constrain spending and hiring plans. Capital expenditures remained sluggish, with most Districts noting little change in recent months. Cleveland and Atlanta noted particular weakness in manufacturers' current capital outlays. Boston and Chicago reported that information technology spending was weak, with Boston noting further softening, particularly for telecom-related software and services. By contrast, Dallas indicated a slight improvement in information technology sales, with one contact noting an increase in orders for replacement hardware such as routers, computers, and monitors. While businesses in much of the country remained cautious about their plans for capital spending in coming months, a survey of Philadelphia District manufacturers indicated that about 25 percent of respondents planned to increase outlays while only 10 percent planned decreases. Reports of demand for legal and accounting services were mixed, while three Districts indicated some softening in advertising.

Most Districts reported that businesses were still very cautious about hiring permanent workers, though Cleveland and Atlanta noted a pickup in the use of overtime and part-time employees. Nearly half of the District reports suggested that manufacturing industries were reducing their payrolls, and two said that retailers were downsizing as well. State fiscal woes were cited as contributing to layoffs in the Minneapolis and Kansas City regions. Staffing services firms generally continued to report soft demand. A large employment agency in New York noted that hiring for midlevel office jobs had been on the rise late in 2002, but had since dropped off. However, Dallas reported improved demand for temporary workers in administrative, light industrial, and professional and technical positions, and Richmond saw scattered increases in manufacturing.

Construction and Real Estate

Nearly all Districts indicated that real estate and construction activities remained mixed, with strength on the residential side and weakness on the nonresidential side. New and existing home sales remained strong in nearly all Districts, with only Dallas reporting that activity was soft. Housing demand generally appeared to be strongest for low- and moderate-priced units. Demand for higher-priced homes remained softer, although Richmond and Chicago noted slight improvement in some areas. None of the Districts reported a general improvement in commercial real estate markets, and three suggested slight deterioration. Most regions said that net new demand for office space remained very weak. Vacancy rates continued to rise somewhat and downward pressure on rents persisted. Philadelphia and Richmond indicated that office-leasing activity picked up as existing tenants renegotiated with landlords for lower rents and/or concessions. Boston also reported an increase in leasing activity, largely due to consolidations. Cleveland noted that state and local fiscal difficulties were having an impact on public construction projects, and St. Louis reported that several announced hospital, church, and college projects have been delayed due to economic uncertainty. Most reports suggested that there were few, if any, expectations of a near-term improvement in commercial real estate and building activities. Cleveland, however, noted an increase in demand for architects' services, which contacts suggested could be a precursor to increased commercial building activity.

Manufacturing

Manufacturing activity generally remained weak nationwide, but half of the reports noted at least some degree of improvement. Richmond indicated that "activity strengthened" as "shipments and new orders rose sharply," and Kansas City said that "activity improved slightly." Only St. Louis suggested a slight deterioration, with increasing reports of weak sales. Light-vehicle production nationwide was flat-to-down from a year earlier, and adverse weather in mid-February led to some plant shutdowns in the Cleveland District. Reports from vehicle parts suppliers were mixed. Firms in the St. Louis District reported diminishing orders for automobile parts, but Atlanta suggested that businesses supplying parts to the new vehicle assembly plants in the region were outperforming other manufacturers. Demand for some high-tech goods was said to be improving. Conditions in the semiconductor industry appeared to improve in the Boston and San Francisco Districts. Dallas added that there was an increase in the demand for some high-tech consumer goods. Apparel makers in two Districts reported better conditions. Manufacturers' inventories of finished goods and raw materials were generally lean, as contacts across the country expressed high uncertainty about the near-term outlook.

Banking and Finance

Lending activity was mixed by market segment. Most Districts indicated that growth in household lending continued to be driven by very strong residential mortgage demand. Refinancing was again spurred by lower fixed-rate mortgage interest rates; one contact in the Richmond region indicated that every 1/8 percentage point to 1/4 percentage point drop in mortgage rates brings in new people. Demand for other types of consumer loans was generally flat-to-down. A few Districts noted slight increases in delinquencies and defaults on some household loans, while one reported slight improvements in loan quality. Standards for household loans were largely unchanged. However, bankers in the Dallas region said that the quality of loan applicants was lower, and Philadelphia suggested that marginal borrowers were finding it more difficult to service their debts.

Business lending activity remained weak in most of the nation, as many bankers suggested that decisionmakers were reluctant to borrow in the face of continued uncertainty surrounding geopolitical and economic conditions. Atlanta reported that the bulk of commercial lending activity was driven by businesses refinancing existing loans. However, bankers in the Philadelphia, Richmond, and Chicago Districts saw slight increases in some commercial lending segments. Bankers in one-third of the Districts reportedly tightened standards on some business loans. There were few indications that overall quality on commercial loans had changed in recent weeks, although bankers in the Philadelphia District noted "some slippage in credit quality," while Chicago bankers suggested modest improvement.

Prices and Employment Costs

A combination of geopolitical uncertainties, very harsh winter weather in the eastern half of the country, and lean inventories led to significantly higher energy costs in January and February. These cost increases were having wide-ranging economic impacts throughout the country--higher raw materials costs for manufacturers, increases in transportation and shipping costs, fuel surcharges, and even job cuts in manufacturing in the Atlanta region. Dallas reported that "gasoline prices at the pump reached the highest February level on record," while one Chicago contact suggested that small freight haulers may be driven into bankruptcy by very high diesel fuel prices.

Upward wage pressures remained generally subdued in nearly all Districts, but some nonwage costs continued to rise, particularly for health and other insurance. Minneapolis reported that two large unions had agreed to pay a portion of their health insurance premiums in order to get 3.75 percent pay raises in each of the next two years.

Few firms said they were able to pass along much, if any, of these cost increases to their customers. Competition from both domestic and foreign producers helped keep final goods prices in check. Most Districts suggested that price pressures at the retail level remained largely subdued, with many merchants still resorting to heavy discounts to move merchandise.

Agriculture and Natural Resources
Agricultural activity remained mixed across Districts. San Francisco reported that the decline in the value of the dollar gave a boost to agricultural exports. Farmland values in the Chicago District posted the largest year-over-year gain since 1997. Higher prices for many agricultural commodities boosted planting, notably for winter wheat in part of the Minneapolis District. Cotton yields hit a record in Texas, and cotton plantings in the mid-South are expected to be higher this year. Increased livestock prices have eased profitability concerns, though reduced herds due to drought could lead to a smaller calf crop this year. The drought reportedly affected agriculture in nearly half the Districts, increasing the need for timely precipitation in the spring. On the other hand, Atlanta and Dallas reported favorable moisture levels. Cold weather had a negative impact on agricultural activity, stressing livestock in several regions, slowing field work in the Richmond District, and causing moderate frost damage in portions of the Atlanta District. Low prices continued to affect the dairy industry, even the most efficient producers. Financial stress has increased in the Chicago District, but few significant farm loan portfolio problems were reported by bankers elsewhere.

Due to higher prices, activity in the energy sector increased, though not evenly. Kansas City and San Francisco reported strong oil and natural gas activity. However, Dallas noted only a mild increase and Minneapolis said energy activity was mixed. Current and potential disruptions to crude oil supplies continued to hamper refining, especially in the Dallas District. Dallas also reported that activity was held down by industry perceptions that the oil price increase was temporary and by a shortage of trained workers. Higher metal prices helped spur mining activity in the Minneapolis District.

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First District--Boston

The First District economy shows few signs of improvement. Retailers cite disappointing December results, although some gained in January and February. Most manufacturing contacts report weak demand. Commercial real estate markets in New England remain very slow. Most software and information technology providers say demand is declining. The outlook is highly uncertain and virtually no contacts are making plans based on expectations of an upturn.

Retail

Most retail contacts in New England report lackluster sales in December, although some contacts report a slight uptick in January and February. Art and graphics supplies reportedly sold well, while electronics sales slowed and inventories rose. Conditions in the travel and tourism sector remain weak; contacts report hotel occupancy rates in the Boston area continue to be low because of soft corporate and international travel. Furniture sales did not meet expectations in December, but reportedly picked up in January and February. A surplus merchandise contact experienced record-high sales in December, having obtained unusually good inventory from big retailers. Hardware stores report double-digit increases in sales compared with a year ago; the harsh weather and fear of terrorism--consumers purchasing items such as duct tape and plastic--have helped boost sales.

Most retailers are holding employment levels steady; two contacts, however, are implementing slight decreases in head count. Wages are mostly constant, although Maine's minimum wage increase has led to some raises even in above-minimum pay rates. Most capital spending plans continue to be minimal. Overall, vendor prices and selling prices are level or falling.

Some retail contacts expect sales to increase slightly over the next six months, while others foresee little improvement. Most contacts are hopeful for a turnaround if the geopolitical uncertainties are resolved in the next six months.

Manufacturing and Related Services

First District manufacturing contacts continue to report few, if any, signs of a pickup in demand for their products in early 2003. Most makers of capital goods and other business products indicate that business is weak, especially for aircraft and power equipment. Makers of consumer products say business is soft or, at best, just meeting plan. Some consumer goods companies indicate new signs of deterioration. For example, one furniture company observes that consumers became more cautious in early February and a label maker says that sales to retailers have been running below expectations in the new year. However, others say that conditions are basically similar to what they observed in late 2002 or even a little better. In contrast to the general trend, sales of supplies and equipment to health-related sectors continue to rise. Contacts in the semiconductor industry anticipate that first-quarter revenues will be up at a double-digit rate from a year ago; however, one firm is continuing to see good momentum quarter to quarter, while another calls the quarterly pattern "flattish."

Selling prices remain under competitive pressure. Although materials costs are generally in check, contacts express concern that rising oil prices will raise costs for items such as plastics and chemicals.

About one-half of the manufacturing contacts expect to shrink their workforce in coming months. Most of the remaining firms are either holding staffing steady following layoffs in recent months or hiring selectively. In 2003 merit pay increases are or will be modest, ranging from zero percent to 4 percent at most firms. Capital spending budgets for 2003 generally are similar to last year's. The few companies planning significant increases cite the need for efficiency improvements or new product development.

Most manufacturers are either anticipating or hoping for a modest improvement in conditions during 2003. However, they remain cautious in the face of economic and geopolitical uncertainties. Contacts variously describe their companies as "focusing inward" … "not spending with confidence, not taking a lot of chances" … "just muddling along" … "[having] absolutely no visibility right now."

Temporary Employment
Conditions in the staffing industry are mixed, with most companies experiencing flat or modest year-over-year growth in revenues and profits during the fourth quarter of 2002 and early 2003. Labor supply remains abundant. Wages and billing rates are largely unchanged, although many respondents express alarm at steady increases in employee insurance costs. Temp hiring in manufacturing and light industry is particularly weak, with Vermont reportedly lagging behind the other New England states. Staffing firms are keeping their own payroll and capital spending low, with few instances of further restructuring or reorganization. Most respondents anticipate modest growth in 2003, particularly during the second half.

Commercial Real Estate
Commercial real estate markets in New England remain sluggish. Respondents report little change in activity since our last contact in November, with any new leasing activity being spurred predominantly by consolidation rather than by expansion or growth. While demand for building purchases continues to be strong, lack of demand for rental space has led to lower rental rates and higher vacancy rates in office markets throughout the region. In the Boston area, the published vacancy rates are around 15 percent in the city and 30 percent in the suburbs, but substantially more space is actually available for rent, as some companies make deals for space that is not even listed for sublease. Rental rates for Class A space have dropped to what Class B or Class C buildings commanded two years ago. With little expectation that the economy will improve in the near future, contacts predict a third consecutive year of negative absorption.

Software and Information Technology Services
The demand for software and information technology services has continued to weaken in early 2003. With some exceptions, contacts in the software industry report flat or negative first-quarter revenue growth ranging from zero percent to minus 12 percent compared with last quarter. January is said to have been atypically slow for several custom applications and network software firms. Providers of telecom-related software and services report soft sales along a continuing downward trend, while firms selling software development tools say demand has been level since November. By contrast, several contacts producing human resources and health-care software report annual revenue growth of more than 10 percent.

Software producers seeing revenue gains continue to add labor. The rest are still adding no jobs, with some firms having reached optimal size and others beginning to struggle to avoid layoffs. Capital spending is level across the sector with few plans for change in the coming months. Companies continue to spend only out of necessity or to complete previously postponed investment projects.

Software and information technology contacts indicate that the outlook has deteriorated since the last quarter of 2002 and is marked by considerable uncertainty. The majority of respondents expect flat to deteriorating demand for the next quarter, partly reflecting increased geopolitical risk.

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Second District--New York

The Second District's economy has generally softened since the last report, with the notable exception of housing, which appears to have regained some momentum. Signs of weakness are particularly evident in the labor market. While business contacts report increased cost pressures, mainly for insurance and energy, these pressures show no signs of feeding into finished-goods prices. The Presidents Day snowstorm had a large effect on the retail sector but little disruptive effect on manufacturing or shipping.

Retailers note that sales were below plan in recent weeks, particularly during and after the blizzard. Selling prices and merchandise costs were described as steady to lower than a year ago, while retail inventories were said to be in fairly good shape. Manufacturers indicate mixed but generally softer conditions in recent weeks; they also note increased upward cost pressures but flat to declining selling prices.

Home construction and the housing market generally have picked up since the last report, though the upper end of the market remains weak. Manhattan's office market has been stable to slightly weaker in early 2003, with rents continuing to fall. Conditions in New York City's financial industry have reportedly deteriorated since the last report. Finally, bankers report some weakening in consumer loan demand, a modest upturn in consumer delinquency rates, and tighter lending standards on commercial borrowers.

Consumer Spending

Retailers report that sales were generally below plan in January and the first three weeks of February. Most contacts were not too concerned with January, which is considered a clearance month. However, the Presidents Day snowstorm had a substantial effect on February sales, and contacts generally do not expect to recoup those sales for quite some time. The storm shut down a number of stores on what is typically a busy sales day and continued to depress business for two to three days. February same-store sales are expected to range from 3 percent to 15 percent lower than last year, mainly due to the snowstorm.

Apparel sales were generally described as weak, though outerwear again performed better than other categories; a number of contacts noted particularly strong sales of jewelry. Demand for home furnishings and appliances was described as mixed. Despite the recent weakness in sales, most retail contacts say that inventories are in good shape. Retailers report that selling prices are flat to down moderately and describe the pricing environment as highly competitive. Merchandise and labor costs are said to be little changed, but retailers report steep increases in utility and insurance costs.

Regional surveys of consumer confidence have given mixed but generally weak signals. Siena College's monthly survey of New York State residents showed confidence rebounding from a cyclical trough in January, led by the New York City area. However, the Conference Board reports that confidence in the Middle Atlantic states--New York, New Jersey, and Pennsylvania--fell to a new cyclical low in January.

Construction and Real Estate

Residential real estate markets have shown signs of regaining steam since the last report, while commercial markets remain soft but stable. New York State realtors report that sales of single-family homes rebounded in December, while selling prices continued to run more than 10 percent ahead of a year earlier, with the steepest gains in the New York City area.

Contacts report that sales of Manhattan co-ops and condos picked up in January and early February and that selling prices have been stable in recent months. The high end of the market, however, continues to lag.

Both single-family and multifamily housing permits in the District rebounded in December, after drifting down in the prior two months. More recently, homebuilders in northern New Jersey report that demand remains strong for homes selling for under $1 million, but note that demand has weakened further at the top end of the market, particularly in areas near New York City. An industry contact notes that labor and material costs are not a problem but that liability insurance coverage is increasingly difficult--builders are more concerned about availability than the rising cost.

Manhattan's commercial real estate market was steady to slightly weaker in January. Lower Manhattan's availability rate inched up, after improving slowly but steadily in the second half of 2002. However, rates held steady in Midtown and edged down in Midtown South. Still, asking rents throughout the city continued to decline; they have fallen by roughly 20 percent from their early-2001 peaks, and industry experts note that the decline in actual rents has been much steeper. On the supply side, there is a moderate amount of new office space currently under construction in Manhattan: roughly 3 million square feet is scheduled for completion this year and another nearly 4 million in 2004. Together, this represents slightly over 1 percent of the total stock, and all of this new space will be in Midtown.

Other Business Activity
A major New York City employment agency, specializing in midlevel office jobs, reports that that hiring activity, which appeared to be on the rise in late 2002, dropped off in January and February. The market for temps is also described as slack. Legal firms are still hiring, and there has been some pickup at magazine publishers; however, there has been very little activity from the usually dominant financial sector. Moreover, a large and growing number of unemployed financial industry workers are looking for jobs.

A contact in New York City's securities industry reports that conditions have deteriorated noticeably since the last report. In addition to increased weakness in the financial markets, stock issuance, and mergers and acquisitions, recent litigation settlements and increased liability have further affected securities firms' bottom lines. Bonus payments are estimated to be down 20 percent to 30 percent from last year's levels, and there is no indication of a pickup in hiring on the horizon.

The manufacturing sector has given mixed signals since the last report. Purchasing managers in both the Buffalo and Rochester areas report some pickup in manufacturing activity in January but further declines in employment levels; they also note widespread increases in input prices. New York City-area purchasers report that manufacturing sector conditions were flat in January, after broad improvement in December, and indicate little change in input prices; while they express increased optimism about the near-term business outlook, a majority anticipates staff cutbacks in the industry in 2003. More recently, our February survey of New York State manufacturers indicates some leveling off in business conditions, following three months of improvement. Manufacturers note increased upward pressure on input costs but downward pressure on selling prices. Respondents also expressed less optimism about the near-term outlook than in recent months. While the survey was taken prior to the Presidents Day blizzard, there has been no indication that the storm had any substantial effect on production.

Separately, a major freight shipping firm reports that the snowstorm had little disruptive effect at the seaports during the subsequent workweek, causing only scattered minor delays. More generally, this contact characterizes shipping activity as very strong.

Financial Developments
Small to medium-sized Second District banks report a further decline in demand for consumer loans, which appears to be partly seasonal, but steady demand in other segments. In particular, 31 percent of bankers indicated lower demand for consumer loans, compared with only 3 percent indicating higher demand. Bankers reported no change in overall refinancing activity.

On the supply side, bankers continue to report tightening credit standards for commercial borrowers--roughly one in six bankers reports tighter standards for commercial and industrial loans, while none reports an easing of standards. Credit standards for residential mortgages and consumer loans remained little changed. Both loan rates and deposit rates continued to decline across the board. Lenders report an upturn in delinquency rates on consumer loans, which cannot be attributed entirely to seasonal fluctuations--twice as many respondents indicate that they are rising as rates are declining. Delinquency rates are reported to be stable in the other categories.

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Third District--Philadelphia

The pace of business activity in the Third District was virtually steady in February, as some sectors improved slightly and others slowed. Manufacturers reported a small increase in new orders for the month compared with January, but shipments were flat and order backlogs declined. Retail sales of general merchandise and auto sales eased in February from January and from February of last year. Bank lending has been rising slowly, with most of the growth coming from consumer loans, although some banks reported recent increases in business lending. Commercial real estate market conditions have shown little change. Vacancy rates have been nearly steady, but effective rents have edged down. Residential real estate sales have been steady at a fairly brisk pace, and builders' backlogs remain high.

Looking ahead, contacts in the Third District business community expect some improvement, although they do not foresee a strengthening in growth. Manufacturers forecast some increases in shipments and orders during the next six months, but their level of optimism has waned somewhat since the start of the year. Retailers anticipate a slow improvement in sales, but they are being very conservative in their sales plans for the spring. Auto dealers expect a pickup in sales as winter comes to an end, but they do not expect to match last year's sales rate. Bankers expect slight gains in lending, but they have become increasingly concerned that loan growth could stall if the pace of business activity in the region does not improve.

Manufacturing
Third District manufacturers reported steady shipments and slight gains in new orders, on balance, in February. However, despite the rise in new orders, order backlogs declined at area plants. Manufacturers continued to report declining inventories, and some firms characterized them as historically low. Also, some manufacturing companies indicated that their customers were maintaining very low inventories and placing orders only on an

as-needed basis. By major industry sector, conditions appeared to be relatively better for makers of apparel and furniture and for some producers of industrial equipment and materials. Conditions were relatively slower among makers of paper products and fabricated metal products.

On balance, the region's manufacturers forecast improvement during the next six months, although they have not been quite as optimistic recently as they were at the start of the year. About half of the firms surveyed in February expect increases in shipments and orders by midyear, but one-fifth anticipate decreases. Area manufacturers' capital spending plans call for increases, on balance, with about one in four scheduling increased outlays and one in ten planning cuts. Most of the firms that are limiting or reducing capital spending for 2003 indicated that they are doing so because demand for their products remains weak, but a significant number mentioned geopolitical uncertainties as a negative influence on their capital spending decisions.

Retail
Third District retailers generally reported that sales in February were somewhat off compared with a year ago, and most of the stores contacted for this report indicated that sales slowed in February compared with January. Store traffic has also declined. Store executives said cold weather and winter storms have hampered shopping, but they also said that fundamental consumer demand has eased. Retailers said sales of home furnishings and electronics have been holding up, but sales of many other types of merchandise, particularly apparel and jewelry, have weakened. Some merchants also noted that there has been a sharp decline in purchases by younger consumers. Discounting continued to be extensive, with many special sales and coupon promotions being offered.

Most of the retailers contacted for this report expect sales to move up sluggishly as the year proceeds. They are being very cautious in inventory planning, and many store executives said they will be trimming promotional spending, particularly for advertising. It appears that retail companies operating in the region will also reduce capital spending this year, but most of the store executives surveyed said the cuts will not be as large as they were last year.

Auto sales in the District slipped in February from the January pace, with declines for nearly all makes. Dealers reported that sales fell as some manufacturers scaled back incentives and dropped further when snowstorms disrupted travel in the region. Dealers said the outlook is uncertain. They expect sales to rise by the spring, although they anticipate results for this year as a whole will be below last year.

Finance
Outstanding loan volume at Third District banks was rising slowly in late January and early February. Much of the growth was in consumer lending, including credit cards and other installment loans. Residential real estate lending continued to move up as well. Some banks noted recent increases in commercial and industrial lending, primarily to small and medium-sized businesses. The gains in business lending were slight, however.

Bankers generally said there has been some slippage in credit quality recently among both business and consumer borrowers. Most of the banks contacted for this report said loan delinquencies have increased, but some noted that the increase in their charge-offs has been proportionately lower than the increase in their loan portfolio's delinquency rate.

Looking ahead, bankers in the Third District expect slow growth in total lending, at best.

Some expressed concern that, unless the economic recovery picks up speed, growth in business and consumer lending will stall. Furthermore, several bankers said marginal borrowers are beginning to have difficulty servicing their current debt, and they anticipate more firms and households will experience financial pressure if business activity and employment do not improve soon.

Real Estate and Construction
There has been little change in conditions in Third District commercial real estate markets in recent months. Surveys by area real estate firms indicated that overall vacancy rates have been nearly steady, with slight increases in some locations and slight decreases in others. The office vacancy rate in the Philadelphia central business district was recently estimated at around 13 percent. The vacancy rate in suburban areas varied. In markets where new buildings have been completed the rate was around 20 percent, but in other markets it was lower. Quoted rents remained fairly stable, but effective rental rates have fallen as landlords have raised tenant improvement allowances and offered rent-free periods. Leasing activity has picked up as many tenants have negotiated new or renewed leases to take advantage of landlord concessions. Although a number of new buildings have been proposed, contacts say construction activity has been easing and is likely to fall further until firms in the region add substantial numbers of new employees.

Residential real estate agents and homebuilders generally reported steady rates of sales in January and February at a fairly strong pace. Price appreciation continued to be strong in many parts of the region, although instances of multiple offers have diminished. Real estate agents expect sales of new and existing homes for the year as a whole to be a few percentage points below last year's level. Builders reported little or no decreases in backlogs, which have been kept up by strong sales while construction has been delayed by adverse weather. Residential construction contractors generally indicated that land prices continue to rise, but materials and labor costs have been mainly steady.

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Fourth District--Cleveland

Economic conditions in the Fourth District remained mixed in January and through the first three weeks of February. On balance, conditions in this report were very similar to the last: Conditions in residential construction were positive. Although trucking and shipping contacts reported a slight seasonal decline, conditions remained generally stable. Manufacturing, banking, and retail reports were mixed. Commercial construction conditions remained poor. Winter weather did have an adverse impact on several businesses in the region. Businesses in retail and construction saw less customer traffic than usual, and many firms across several industries temporarily closed operations because of severe winter weather during the survey period.

While hints of future improvement can be found in this report (for example, new orders in manufacturing increased slightly), little suggested conditions would change in the near future. In the current environment, contacts remained reluctant to forecast future economic conditions--most are basing future decisions on the expectation that conditions will remain flat over the next few months. A few firms reported reducing their capital expenditure plans since the first of the year, but most appear to have adopted a wait-and-see attitude before changing their budgets.

Labor market conditions have deteriorated since the last report--several manufacturers reported having reduced their labor forces or planning to do so. The few firms that were looking for employees reported no trouble in hiring--one contact reported 8,600 applications for 200 jobs at a new facility that would be opening in the near future.

Manufacturing

In manufacturing, most nondurable goods producers reported flat or slightly increasing conditions compared with the end of 2002 and reported year-over-year increases in production and sales for January 2003. Durable goods manufacturers were not so uniform--some reported year-over-year declines in production and sales while others reported flat or improving conditions compared with a year ago. While reports on production and sales varied, reports on other business indicators were more similar. Most contacts reported idle capacity (some as much as 40 percent or 50 percent), curtailed capital expenditures, and labor force reductions. Those that increased production did so using overtime rather than by expanding their labor force. Reports regarding input prices were mixed, with roughly half our contacts noting significant increases, while the other half reported flat or declining prices.

Looking forward, most contacts reported flat or slightly increasing new orders, suggesting a slight pickup in production in the coming months, but most firms were making no plans to increase their labor force or capital expenditures in the near future. Most contacts reported that they would be able to respond to a sudden pickup in demand by bringing their idle capacity on line.

Severe weather curtailed District auto production during the third week of February, closing several plants in the area for at least one day. Despite these closings, roughly half the District auto plants reported year-to-date production above 2002 levels, and others reported year-to-date figures very near 2002 levels.

Demand for steel continued to soften in January and during the first three weeks of February. Production and sales were slightly down from December 2002 levels but significantly below January 2002 levels. Steel prices remained under downward pressure even as the cost of production increased significantly throughout the winter. Many contacts expect significant reductions in the steel industry's labor force as companies renegotiate labor contracts. Labor reports were mixed among companies that did not have negotiated labor contracts: Some reported that they were planning to hire back some of the many workers they laid off in 2002, while others reported that they would lay off more workers if conditions in the industry did not improve in the next month.

Retail Sales

District retail reports remained mixed in January, ranging from slight declines (-1.2 percent) to strong gains (4.0 percent) in year-over-year comparable store sales. Although sales for Valentine's Day were characterized as robust, retailers reported that sales for the month of February were trending downward. Apparel retailers noted that seasonal promotions and clearance events had allowed them to move merchandise and reduce inventories. Most retailers are very carefully managing their inventories, as they expect sales to be flat in the coming months.

Automobile dealers in the District characterized sales in January as "lethargic" (one contact noted that year-over-year sales were down 10 percent), but February reports were mixed.

Most contacts noted a rebound in sales, but a few continued to report declines. Although dealers reported significant cuts in their advertising budgets (some as high as 20 percent), they were optimistic about sales in the coming months as manufacturers continue to offer incentives. As was the case in the last report, inventories remain high (seventy-five- to one hundred-day supplies--a sixty-day supply is preferable), but contacts were not as concerned about climbing inventories as they were in the last report.

Construction
District homebuilders reported that sales were steady, at levels slightly higher than at the start of 2002. Despite some slowing in consumer traffic (partially attributed to poor weather), demand remained reasonably strong in a favorable interest rate environment.

Commercial builders, on the other hand, continued to report weak conditions. Worsening state and local budget crises have had an impact on the availability of public construction projects (a major source of business for some firms in 2002). Competition for available projects in all areas of commercial construction has increased. Some contacts noted, however, that architects have been seeing an increase in business, suggesting a pickup will occur in commercial construction in about a year.

Trucking and Shipping
Trucking and shipping activity slowed again in January, although most of this slowing was seasonal. Compared with one year ago, shipping volume in January was nearly flat--most contacts saw a year-over-year increase of about 0.5 percent. Contacts are expecting February shipping volume to remain flat, but note that the industry will see a seasonal pickup in March with an increase in volumes from auto manufacturers and their affiliated companies.

For the first time in many reports, the industry experienced downward price pressure as companies respond to slowing demand (in the last report, contacts reported price increases). Profit margins have been shrinking as input prices, especially labor and energy, continue to rise. Companies are attempting to contain capital spending to replace worn-out equipment--several contacts noted recycling trucks or buying them off the secondary market.

Banking
In the banking sector, both commercial and consumer loan demand remained weak. Compared with one year ago, most contacts reported demand was flat or slightly down, but, for the first time in many months, some contacts reported that demand growth for mortgages was "robust" (attributed to both new and refinancing activity). For most banks, however, home equity loans continue to be the only source of growth in lending. The number of loan applications remained flat, and the credit quality of consumer loan applicants remained very poor. Competition for creditworthy borrowers remains intense. Contacts offered conflicting reports regarding loan delinquency behavior.

Reports regarding core deposit growth were also mixed, with a few contacts reporting declines, but most reporting no change or growth. Those that reported growth attributed it to heavy promotions, including free checking. Most contacts reported a continued squeeze on spreads as loan rates adjust downward and funding rates remain relatively constant.

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Fifth District--Richmond

Economic activity in the Fifth District grew modestly in January and the first three weeks of February, with a slight improvement in services and manufacturing conditions offsetting a listless retail sector. Services businesses reported generally steady to slightly higher demand, and some contacts cited higher orders for coming months. District manufacturing activity expanded somewhat faster, as shipments and new orders rose sharply in January and early February. In contrast, retail sales were little changed from our previous report, and retailers continued to trim payrolls. Price inflation remained modest according to contacts. In the real estate sector, District home sales rose at a solid rate, but commercial leasing activity slowed as war prospects unsettled potential lessees. In agriculture, unusually cold and snowy weather hampered field preparation and led to the abandonment of still-unharvested crops in some areas of the District.

Retail
District retailers reported generally flat sales over the past six weeks. A major winter storm over the Presidents Day weekend led many District businesses to close for a day, and lingering snow curtailed sales. According to a department store manager in Annapolis, Md., sales growth and customer traffic there had been unchanged in recent weeks. And in Richmond, Va., where the winter storm closed several malls, a contact said that store sales were off but that some of the slack might have been made up through increased Internet sales. A manager at a builders supply store told us even though customer traffic was lower because of the recent storm, his store experienced a run on duct tape and other items recommended for use in the event of domestic terrorism. In Virginia Beach, Va., retailers reported a slight decrease in customer traffic as military deployments continued in that area. Car dealers in Washington, D.C., and Charleston, W.Va., said business was very slow, with manufacturers incentives shoring up sales.

Services
Most services businesses said customer demand was steady to slightly higher in January through late February, but firms that do business with the federal government reported decreased revenues. A contact at a financial services firm in Baltimore, Md., said business was stable and that there was less of a "negative feel" in the local economy. In West Virginia, a caterer said her bookings had been slow the past few weeks but noted that her calendar for late spring and summer was filling. Most firms indicated that their employment levels have been steady. An executive search firm in the District of Columbia said they have had to "market a little harder," and a health club also in District of Columbia, said they were seeing more clients. An engineering firm in Charlotte, N.C., reported a shortage of qualified, licensed engineers in the area but a glut of business managers.

Manufacturing
District manufacturing activity strengthened in January and early February. Shipments and new orders rose sharply at District factories, led by a pickup in the chemicals, paper, and textiles industries. A textiles manufacturer in North Carolina told us that aggressive price reductions were enabling his company to gain market share. Furniture manufacturers noted that sales were strong in early January, although inclement weather later in the month tempered growth. Despite the recent uptick in demand, a number of manufacturers expressed concerns about rising oil prices and the possibility of war. A producer of plastic products in North Carolina told us, "Things are very uncertain now; business isn't getting any worse, but there will likely be no sign of a real pickup in activity until the Iraq situation is cleared up." A tire manufacturer in Virginia noted that 70 percent of his firm's raw

materials were derived from oil. He said that the rising costs of oil and natural gas were pushing up the prices of raw materials but that he could not pass the higher costs through to his customers.

Finance

Contacts at District financial institutions said that loan demand changed little in January and February. Commercial lending remained weak, in part because of the uncertainty over Iraq, but there were some encouraging signs that demand for commercial loans may be ticking up. A banker in Charlottesville, Va., said that he had made a few more business loans in recent weeks and noted that some of his clients were beginning to expand business. In contrast, a lender in Richmond, Va., reported that commercial lending was "no better, no worse" than it was late last year and that her clients were "doing well to just keep from losing business." Residential mortgage lending remained strong as mortgage rates drifted lower, and most contacts said that the growth in mortgage lending matched December's pace. Residential refinancing continued strong, accounting for 60 percent to 75 percent of home mortgage lending in many cases. A mortgage lender in Richmond, Va., said that interest in refinancing was still strong, observing that "every 1/8 percent to 1/4 percent drop in mortgage rates brings in new people."

Real Estate

Residential realtors generally reported that home sales were solid in January and February. An agent in Greenville, S.C., said local sales were the best he had seen in forty years. He commented that sales were so good he was afraid to say too much "for fear of jinxing them." A realtor in Odenton, Md., also reported strong sales in January, adding that properties put on the market in her area did not last long. In Richmond, Va., an agent said that the remarkable string of monthly sales advances in that area remained intact. In a less rosy assessment, real estate agents in the District of Columbia said sales had been somewhat slower in recent weeks--in part because of inclement weather in the region. Across the District, homes in the low-to-middle price range were selling best, but a few realtors said that interest in higher price homes was picking up. Home prices were reported to be rising modestly in most locations.

Commercial realtors reported slower growth in leasing activity in recent weeks as potential lessees in the office sector adopted a "wait and see" attitude in light of political developments internationally. A realtor in Raleigh, N.C., captured the mood of many with the observation that "people are just waiting on the sidelines." The leasing of retail space picked up--a realtor in Richmond, Va., for example, experienced "very high" growth over the past six weeks in retail leasing. But office and industrial space leasing was sluggish. Vacancy rates for retail space remained low, while office vacancy rates edged higher. Rents for retail space held firm, but edged lower for office space. Realtors in Washington, D.C. and Charlotte, N.C., noted that some tenants had recently renegotiated their leases, obtaining lower rents and other concessions. New commercial construction was generally flat across sectors--several realtors in the Carolinas reported a shift to refurbishing older buildings in lieu of building new ones.

Tourism

Tourist activity strengthened since our last report. Contacts at several District ski resorts told us that abundant snow in February rejuvenated interest in skiing. They noted that bookings over the Presidents Day weekend were much higher than last year and predicted that the ski season would be extended through late March. Coastal tourism was also reported to be stronger. A contact from Myrtle Beach, S.C., said that Presidents Day weekend had been extremely busy, adding that it was difficult to get into a local restaurant without a reservation. Looking ahead, contacts expressed concern that rising gas prices and continued talk of war could hamper the spring tourist season.

Temporary Employment
Contacts at District temporary employment agencies reported lukewarm demand for workers in recent weeks. An agent in Washington, D.C., reported that he had expected a better start to the new year but said, " Business is still very soft, and demand for extra workers is slower than expected." While overall demand for temporary workers was flat, continued strong residential mortgage lending resulted in higher demand for temporary workers in that sector. In addition, there were scattered reports of a pickup in hiring in manufacturing.

Agriculture
Frigid weather in January and heavy snowfall in early February impeded field preparation and limited late small-grain plantings in much of the District. Farmers in Maryland, North Carolina, and Virginia abandoned some remaining corn and soybean fields in January because of the cold weather and anticipated poor yields. The cold weather also curtailed development of pastures and winter grazing crops--farmers were feeding livestock full time and trying to stretch hay supplies. Although some areas in South Carolina continued to experience moderate drought conditions, contacts in most areas of the state reported that small-grain crops were in good condition.

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Sixth District--Atlanta

Contacts reported that economic activity in the Sixth District remained lackluster in January and February. Retail sales were sluggish, while manufacturers noted continued weakness outside of defense and auto-related production. The District's tourist sector continued its gradual improvement. Labor markets displayed a modest improvement in January and February; employers reportedly remained reluctant to add permanent staff but increased their use of overtime and part-time workers. The District's single-family housing market remained strong, but commercial real estate markets continued to suffer from low demand for space. Most contacts indicated that geopolitical concerns and higher fuel prices were weighing on near-term expectations for the District's economy.

Consumer Spending
The majority of District retail contacts reported that January and February sales were about the same as they were a year earlier. Aggressive discounting remained prevalent, especially among apparel merchants that were clearing out winter clothing. Most retailers contacted indicated that inventories were balanced, and some noted that stocks were lower than this time last year. Several national retail chains announced planned store consolidations in the District. Automobile industry contacts reported mixed light-vehicle sales in January and February, while the demand for used-car sales remained soft.

Real Estate and Construction
Low mortgage rates continued to propel District housing markets in January and February. The strongest reports in the District were from Florida, while contacts reported that home

sales and construction elsewhere were mostly stable. High-end homes remained difficult to sell in most parts of the region. Reports noted that commercial real estate markets remained weak in January and February. Vacancy rates increased in some metropolitan markets, and new construction was largely limited to public works projects. Several contacts noted that generous lease incentives were prevalent, but absorption remained at low levels.

Manufacturing
Overall, factory activity remained lackluster in January and February. Most manufacturing firms reported no significant increases in demand. Inventories remained lean, and capital spending plans were subdued. Petrochemical and ammonia plants in Louisiana have announced job reductions because of high natural gas prices. Production has been scaled back at a steel plate plant in Alabama because of slack industrial demand. The District's timber and forest products industry continued to experience low prices and stiff competition from imports from Canada, Europe, and South America. Contractors for NASA in Florida and Louisiana expressed concern that activity may slow following the Columbia tragedy. The most positive reports came from firms supplying the new vehicle assembly plants in the District and from defense contractors.

Tourism and Business Travel
Tourism contacts reported a gradual improvement in business conditions in January and February. In Florida, reports suggested that the level of activity still lagged behind that of early 2001 but exceeded year-ago levels. The number of visitors to Miami over the past few months was boosted by the success of several special events in the city and particularly inclement weather in the North. Cruise activity remained strong through Florida ports. Gaming revenue was characterized as exceptional for Louisiana casinos over the holidays, but the pace dropped off in January.

Banking and Finance
Responses from the banking sector were mostly positive in January and February. Residential loan demand and refinancing activity continued to be strong overall, although there were reports of increasing mortgage default rates in some areas. The vast majority of commercial loan activity was among businesses refinancing existing loans. Banking contacts reported ongoing moderate deposit growth. Venture capital investment activity remained low in most of the District.

Labor and Prices
Most business contacts continued to report that they were reluctant to increase permanent staffing levels. However, a number of firms noted that they had increased the use of overtime and part-time workers during January and February. Local and state governments were cutting back on hiring plans because of budget constraints. The main areas of employment growth were in the health-care sector and at newly expanded vehicle production facilities in the District. Insurance costs continued to escalate throughout the District, and while most reports indicated little change in output prices, input costs related to oil and gas increased significantly.

Agriculture
Some crops in southern Florida and south Louisiana received moderate frost damage in February, but most areas emerged largely unscathed from recent cold snaps. Winter rains have helped reduce drought conditions in several District locations.

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Seventh District--Chicago

Reports from Seventh District contacts generally suggested that economic activity remained soft in January and February. Consumer spending was again relatively weak, and caution persisted in businesses' capital spending and hiring plans. Strength continued in sales of both new and existing homes, while nonresidential building and real estate activities were again soft. Manufacturing activity remained generally weak but appeared to have improved further from our last report. Bankers continued to report strong mortgage demand from households and weak loan demand from businesses. There were a few new reports of input cost increases, particularly for energy, but prices at the retail level remained largely in check. District farmland values in 2002 posted the largest year-over-year gain since 1997, even as concerns increased about the impact of drought and continued low dairy prices.

Consumer Spending
Overall consumer spending remained weak in January and February. Most retail contacts indicated that sales results in January fell short of their conservative expectations, although one national chain noted some slight improvement in February. Merchants said that sales of food and consumables were stronger than other items, particularly apparel. Inventories generally remained lean as retailers sought to tightly control stocks, although one merchant reported that inventories were rising faster than sales. A contact in casual dining noted that sales had been softening since mid-January, in part because of bad weather and increased fears of terrorism. Auto dealers indicated that light-vehicle sales in the District had slowed from the torrid pace of year-end 2002, particularly in February. Contacts said that light-vehicle inventories were higher than desired, with one noting that "some dealers are getting nervous," given the great deal of uncertainty about sales in coming months. A manufacturer of recreational vehicles said that demand for lower priced units remained strong but that the high end was "suffering." Tourism activities were reported to be flat to down in most areas, and one contact noted fewer attendees at boat and RV shows in the region.

Business Spending
Business spending generally remained weak in January and February. Most contacts suggested that there had been little, if any, change in their actual capital spending or investment plans early in the year. Many expressed uncertainty about the strength of the economy and continued to take a "wait and see" attitude. One computer industry contact indicated that businesses continued to defer both upgrades to mainframe equipment and additions to capacity, which were also adversely affecting software vendors. There were a few reports of stronger advertising activity in January, but it had softened somewhat in February. Business travel remained weak, and there were some reports of firms encouraging workers to postpone or cancel business trips as a result of the increased threat of terrorism. Hiring plans remained very cautious. Reports from temporary staffing firms were mixed but generally indicated that demand remained lackluster. Contacts from many industries suggested that uncertainty about overall economic conditions and the need to contain costs were constraining hiring.

Construction and Real Estate
Construction and real estate activity was again strong on the residential side and soft on the nonresidential side. Sales of both new and existing homes remained strong, according to

homebuilders and realtors. Demand for lower priced homes was strongest in most markets, although there were a few reports of improving demand for higher priced new homes in some. One builders association in Wisconsin noted record attendance at their annual home show in January, with builders and remodelers optimistic about the "quality of leads" from the show. Apartment occupancy rates continued to trend down, despite little new development of multifamily rental units. Nonresidential activity remained weak. Office vacancy rates crept up in some markets, in part because of lease termination agreements. While these deals increased official vacancy rates, they also reduced the amount of sublease and "shadow" space on the market. One contact said of office leasing activity, "As for net new demand, we're just not seeing it." Some reports suggested that vacancies rose in some older retail developments and that the number of new retail projects in the pipeline was slowing.

Manufacturing
Overall, manufacturing activity remained generally soft but continued to show signs of improvement. Nationwide, light-vehicle sales slowed in January and February but were still tracking at historically strong levels. A contact with one automaker said that the industry expected volatile sales in coming months, and manufacturers were prepared to raise incentives to smooth out sales volumes. This contact also noted that production was down slightly from a year ago, and inventories were a little high. A producer of heavy trucks said that sales had been gradually improving after bottoming in August of last year, and it appeared that "people are buying the new engines" that meet more stringent EPA emissions standards. Production was also holding up, with no plans for additional plant shutdowns. Strong shipments to China were said to be helping buoy steel production, according to one industry contact, but inventories had increased somewhat in recent months. A few producers of machine tools reported that quoting activity (especially for larger projects) was up, and this was translating into some new orders.

Banking and Finance
Overall lending activity continued to reflect the bifurcation in economic activity, with strength on the household side and softness on the business side. Applications for mortgage refinancing may have slowed somewhat, but remained much stronger than most bankers had anticipated. Contacts noted some improvement in household loan quality, as delinquencies and charge-offs decreased modestly. Business lending activity remained very weak. A contact with one large bank said soft business demand was reflected in relatively flat loan volumes, a trend that has persisted over the past six months. Banks that did experience volume increases suggested that the gains were due to market share shifts rather than a general increase in demand. On balance, banks did not appear to be tightening standards on business loans, and there were a few reports that overall business loan quality had improved slightly.

Prices and Employment Costs
There were a few new reports of increasing input costs, but retail price increases remained largely subdued. Of particular concern to many contacts were rising prices of energy and inputs derived from petroleum. One contact said that prices for diesel fuel had risen to "frighteningly high" levels, which could potentially send some small freight carriers into bankruptcy. By contrast, steel prices were said to be stabilizing after some significant increases in 2002. There were no new reports of intensifying pressure on wages, and some companies were said to have delayed merit increases until later in the year. Businesses continued to express concern over rising health and other insurance costs. Despite some

increases in input costs, fierce price competition kept most output prices in check. Small-business owners appeared particularly concerned with this trend, as they were finding it increasingly difficult to compete with larger producers on price.

Agriculture
On average, District farmland values at the end of 2002 were up more than 7 percent from a year earlier, the largest year-over-year gain since 1997, according to our survey of rural bankers. Nearly 40 percent of eligible farms in the District had signed up for aid under the Farm Security and Rural Investment Act of 2002, with a crush of applications likely this spring. With drought covering about half the District and another third of the region abnormally dry, there was increasing concern about the growing season. Corn and soybean prices remained higher than a year ago, and contacts suggested prices could rise further, given low stocks and the potential for drought conditions to reduce yields. Higher crop prices had already led food producers to raise some prices. Very low dairy prices and low crop yields last year in parts of Illinois and Indiana contributed to increased financial stress in the District's farm sector.

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Eighth District--St. Louis

Contacts in the Eighth District reported lackluster business conditions in recent months, with little change from the last survey. In manufacturing, reports of weak sales, consolidations, closings and cutbacks have continued. Retail sales during December and January were mostly flat from a year ago but met expectations. Auto sales over the same period declined. Residential real estate markets are still strong, while commercial real estate markets remain weak. Over the past three months, there was essentially no change in lending activity.

Consumer Spending
Contacts reported that retail sales in December and January were flat to slightly up, on average, from year-earlier levels. More than 70 percent of the retailers surveyed noted that sales levels met their expectations, while about 25 percent of the contacts reported that sales were below expectations. Apparel, shoes, home items, cosmetics, and winter items were strong sellers, while jewelry, specialty, and luxury items moved more slowly. Despite a slow holiday season, over half the retailers surveyed noted that inventories are at desired levels, while only 20 percent reported excess inventories. Most contacts indicated no current plans for discounting merchandise. Retailers remained cautiously optimistic about the next few months, with about 65 percent of contacts expecting a small increase in sales from last year and while the rest expecting sales to remain flat or below 2002 levels.

Car dealers in the District reported that sales in December and January were down over year-earlier levels, on average. Almost all contacts attributed this trend to an uncertain economy and the threat of war. Several car dealers reported that used and low-end cars are selling better than new cars, causing inventories of used cars to be okay-to-low and inventories of new cars to be okay-to-high. About 35 percent of the contacts surveyed noted higher rejection rates of finance applications, while the rest saw no change. A third of the dealers surveyed expect sales to be flat-to-slightly-down over last year in the next few months, the rest expect a moderate increase.

Manufacturing and Other Business Activity
The District's manufacturing sector remains soft. Reports of weak sales, consolidations, closings, and cutbacks continue to rise. Most contacts also noted diminishing orders and low selling prices. Industries affected include packaging, appliances, automobile parts, fluorescent lights, tools, electrical products, paper, and steel cable. Contacts see an uncertain economy and increased foreign competition as the causes for weakness. Several manufacturers are somewhat pessimistic about the first half of the year. Despite the overall slowdown, a few firms in the dye, clothing, stationery, and ventilator industries have announced plans to expand in or move to the Eighth District.

The increasing price of diesel fuel has many contacts from small and midsize trucking firms concerned about their already narrow profit margins. A major packing and shipping firm in the District has announced a plan to lay off pilots in the next year, citing a decrease in shipping volume as the reason for the cut. In the health-care sector, contacts noted that the nursing shortage has persisted, especially in the non-urban areas of the District. Contacts in all industries continued to experience the burden of increasing health-care insurance costs.

Real Estate and Construction
Residential real estate sales are still up in most of the District. Last year was a record year for home sales in Memphis, with an increase in total home sales of 20 percent in December 2002 compared with December 2001. In Arkansas, home sales were very strong the last two to three months of 2002 but slowed as the weather turned colder. Residential construction is also up in most District areas. In Louisville, contacts noted that housing starts are booming for homebuyers in the $100,000 to $150,000 range. Contacts in Fayetteville reported that housing starts continue to flourish. In the Greater St. Louis area, year-to-date single-family housing permits as of December 2002 were up 4 percent from 2001.

Commercial real estate markets are still slow in most of the District. St. Louis continues to experience an increase in office vacancy rates. Contacts in both Louisville and Fayetteville reported increased office vacancy rates at the end of 2002. Commercial construction is weak in most District areas. In northeast Arkansas, activity has continued to be slow and is not expected to pick up in the spring. In Memphis, contacts reported that there is virtually no building. In central Kentucky, construction of hospitals, churches, and college facilities are under way or have just been completed, but several that have been announced are being delayed because of uncertainty about the economy.

Banking and Finance
A recent survey of senior loan officers at a sample of District banks indicates little change in overall lending activity over the past three months. Banks' credit standards for commercial and industrial (C&I) loans remained generally unchanged by large firms but were slightly tightened for small firms. Most contacts reported a moderate decrease in the demand for C&I loans for large and small firms, citing a decrease in merger and acquisition financing needs and reduced plant investment as reasons. The survey introduced questions about credit default swaps (CDS), but it appears that banks make very little use of them in either buying or selling credit risk, because, according to the respondents, CDS are more expensive, riskier, and more complicated instruments than loans. Credit standards for commercial real estate loans were tightened somewhat even though demand remained about the same. Both the credit standards and the demand for residential mortgage loans were reported to be generally unchanged. Credit standards for credit card and consumer loans

remained largely unchanged, but the demand for consumer loans decreased moderately.

Agriculture and Natural Resources
Unusually cold weather in the Midwest stressed livestock and threatened winter crops. Despite a good amount of snow covering the southern part of the state, Illinois winter wheat ratings have continued to decline. Low levels of topsoil moisture add to concerns about the survival of the crop. Rains will be particularly important in late February and March as the crop breaks dormancy. According to a major survey, cotton producers in the mid-South intend to plant 3.3 percent more cotton this year than in 2002. The number of catfish operations in District states decreased, on average, 8.1 percent between 2002 and 2003. Water surface acres used for production decreased 8.5 percent, on average.

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Ninth District--Minneapolis

Ninth District economic activity was mixed from early January through late February. Agriculture, home building, and mining grew. Manufacturing, tourism, and energy were mixed. Consumer spending was flat and commercial construction was down. Over this period, labor markets loosened slightly. Overall wage and price increases were modest. Significant price increases were noted in heating costs, gasoline, and tuition.

Construction and Real Estate
Commercial building was generally down. In 2003, only about 200,000 square feet of new space is planned in the Minneapolis-St. Paul area, down from 1.2 million square feet in 2002, according to a commercial real estate firm. A Minneapolis firm that reconfigures office space and moves furniture reported less work in January and February than in the last months of 2002. However, in Sioux Falls, S. Dakota, building permits were up in January compared with a year ago; commercial realtors, developers, and architects are expecting a good year in 2003, according to a city official.

Home building and residential real estate activity were solid. The number of housing units authorized in the Minneapolis-St. Paul area increased 14 percent in January compared with a year earlier. "Every indication is that 2003 should be another very busy year for builders," said a representative of a Minneapolis-St. Paul area builders association. However, the vacancy rate for apartments in Minneapolis-St. Paul increased to 6.6 percent in the fourth quarter of 2002, up from 4 percent a year earlier. A representative of a realtors association in La Crosse, Wis., expects 2003 to be another good year for single-family home sales, but says 2003 will likely fall short of the 2002 sales record.

Consumer Spending and Tourism
Overall retail sales were flat. A major Minneapolis-based department store and discount retailer reported that same-store sales were essentially flat in January compared with a year ago. According to a representative of a chamber of commerce association, retailers in Minnesota were not complaining about post-holiday sales, but they carried low levels of inventory. A Minneapolis area mall manager noted flat sales in January compared with a year ago, while a mall in Montana reported sales down slightly in January from last year. In contrast, another Minneapolis area mall manager reported good traffic levels in January and February, while a mall manager in North Dakota noted that the mall's annual post-holiday sale had higher traffic levels than a year earlier.

Auto sales dipped in January from December levels. According to a representative of an auto dealers association in Minnesota, after a good December, auto sales have "fallen off a cliff." An auto dealer in Minnesota noted a significant slowdown in sales at several stores in January.

Winter tourism was mixed, primarily due to weather. The first seven weeks of the winter tourism season were a "washout" due to a lack of snow in the Black Hills area of South Dakota, according to a tourism official; however, since the end of January, business has been up about 10 percent over last year. Businesses in northern Wisconsin that depend on snowmobiling and cross-country skiing are hurting, reported a university extension agent. In contrast, plenty of snow in the Upper Peninsula of Michigan led to a recent 10 percent increase in lodging expenditures in January compared with last year.

Manufacturing
Manufacturing activity was mixed. A January survey of purchasing managers by Creighton University (Omaha, Neb.) indicated increased manufacturing activity in Minnesota and the Dakotas. As evidence, a Minnesota prescription drugs manufacturer plans to significantly increase capital purchases and employment, and an industrial equipment maker will expand production in western Wisconsin. However, preliminary results from a January survey of District manufacturers by the Federal Reserve Bank of Minneapolis and the Minnesota Department of Trade and Economic Development revealed that businesses expect employment and capital investment to decrease slightly in the first half of 2003 from the second half of 2002. Several District manufacturing facilities recently announced plans to close, including a western Wisconsin tool factory and an electronic component plant in southern Minnesota.

Energy and Mining
Activity in the energy sector was mixed, while the mining sector was up slightly. Mid-February District oil and natural gas exploration levels were down slightly, while oil production was up slightly from early January. Meanwhile, two District iron ore mines were operating at near capacity and expect to increase employment. District metal mines enjoyed significant increases in gold prices and moderate price increases for other metals.

Agriculture
The agricultural economy was generally up due to higher commodity prices. The U. S. Department of Agriculture reported that farmers and ranchers received slightly higher prices for their products in January compared with December. January hog and beef prices were up 5 percent and 3 percent, respectively, from December. January poultry and egg prices were up 13 percent from a month earlier. However, January dairy prices were down 1 percent. In response to higher wheat prices, Montana farmers planted 21 percent more acres of winter wheat than last year, despite continued drought conditions. Ranchers in the western part of the District have reduced herds due to the drought and, therefore, a smaller calf crop is expected this year.

Employment, Wages, and Prices
Several upcoming layoffs were announced since the last report. In Rochester, Minn., a high-tech manufacturing company will lay off most of its 550 workers by June. A financial services organization with headquarters in Minneapolis just announced plans to lay off 500 employees companywide due to merger issues. In North Dakota, a bus manufacturing plant

will lay off up to 230 employees. A credit card issuer recently announced plans to cut 100 jobs in Minnesota. In several areas of the District, state and local government budget problems may be addressed in part through job reductions. For example, more than 1,000 Minnesota state workers could be laid off by June 30. School Districts in the Upper Peninsula of Michigan noted that reductions in state aid will likely result in layoffs.

In contrast, a health benefits company in Duluth, Minn., plans to hire another 60 to 70 employees over the next six months. A call center in South Dakota has hired 160 people since the beginning of the year and plans to hire 175 more. A telemarketing company that opened in South Dakota in February plans to hire as many as 50 employees, and a call center in Billings, Mont., will add 50 jobs.

Wage increases were modest. About 75 percent of respondents to a recent survey by the St. Cloud (Minn.) Area Quarterly Business Report indicated no change in employee compensation during the last three months of 2002. In Eau Claire, Wis., two large unions agreed to pay a portion of their health insurance premiums in exchange for pay increases of 3.75 percent during each of the next two years.

Overall price increases were modest, except for significant increases in heating costs, gasoline, and tuition. Only 10 percent of respondents to the St. Cloud (Minn.) Area Quarterly Business Report poll raised product prices during the last three months of 2002, while 16 percent decreased prices. Heating costs may rise as much as 10 percent to 35 percent over a year ago in several areas of the District due to colder weather and higher natural gas prices, according to energy companies. Gasoline prices at pumps in Minnesota were about 50 percent higher than a year ago. Tuition and fees at four-year public universities in North Dakota were up 14 percent for this academic year.

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Tenth District--Kansas City

The Tenth District economy showed some signs of strengthening in late January and February, despite widespread uncertainty among businesses and consumers. Retail sales posted slight gains, manufacturing activity improved, and energy activity picked up. In addition, residential real estate activity continued at a strong pace. On the negative side, auto sales were weak and commercial real estate remained in a slump. In the farm economy, many ranchers and farmers continued to suffer from the effects of drought. Wage and price pressures remained largely subdued across the District.

Consumer Spending
Retail sales in the District improved slightly in late January and February after a sluggish holiday season. Sales were above year-ago levels at most stores and flat or only slightly lower elsewhere. Many retailers attributed the recent gains to heavy discounting. Among product categories, apparel and electronics sold particularly well, while sales of some types of home furnishings were weak. Most managers were optimistic about future activity after solid Valentine's Day sales and expect some inventory building leading up to the Easter season. Motor vehicle sales were flat after declining at the end of last year but were only slightly below year-ago levels in most areas. Compared with contacts in other industries, auto dealers appeared to be more adversely affected by uncertainty over a possible war with Iraq. Still, most dealers expect solid sales by summer. In the tourism industry, activity at

Rocky Mountain ski resorts remained solid after record numbers of visits during the holidays.

Manufacturing

District manufacturing activity improved slightly in late January and February after slipping in December. Production, shipments, and new orders at District firms rose back above year-ago levels, and many firms reported small increases in capacity utilization rates. However, new hiring and capital spending remained weak, and inventories of raw materials fell. Firms appeared somewhat apprehensive about activity in the immediate future, but their optimism about production activity later in the year was quite high. Although manufacturing employment is also expected to pick up by the summer, capital spending is not expected to change much from current modest levels.

Real Estate and Construction

Residential real estate activity in the District remained strong in late January and February, although commercial real estate activity weakened further. Single-family housing starts throughout much of the District rose from already high levels. Most of this strengthening continued to be for lower priced homes, but there were also reports of increased construction of midrange homes in some areas. High-end home building, on the other hand, largely remained in a slump. Most builders expect home construction to remain solid in coming months, although builders in some drought-stricken areas were concerned about the effects of new water restrictions on permit applications. Home sales across the District were also solid, though reports were not as uniformly strong for housing starts. In the months ahead, most realtors expect sales to continue at the recent pace. Mortgage demand remained strong throughout much of the District, as refinancing activity continued at high levels. Nearly all recent refinancings have been used to reduce monthly payments-a contrast from previous surveys, when a sizable portion of refinancing activity was for the purpose of taking out cash. Lenders generally expect mortgage demand to stay solid and to possibly increase further in the spring. Commercial real estate activity remained weak across the District, with some markets experiencing even further deterioration. Office vacancy rates rose again in Denver, and commercial construction activity fell in nearly all markets. Absorption and prices of office space were down slightly in most areas, and many landlords were offering rent concessions to keep or attract tenants. Commercial realtors generally do not expect a turnaround in activity any time soon.

Banking

Bankers report that loans and deposits both held steady since the last survey, leaving loan-deposit ratios unchanged. Demand increased for home mortgage loans but edged down for consumer loans. Demand for other loan categories was largely unchanged. On the deposit side, small increases in NOW accounts and money market deposit accounts were offset by a slight decline in large CDs. All respondent banks left their prime lending rates unchanged since the last survey, and most banks also held their consumer lending rates steady. Lending standards were unchanged.

Energy

District energy activity expanded in late January and February in response to the rise in energy prices that began in mid-December. The count of active oil and gas drilling rigs in the region has risen more than 30 percent since the beginning of the year and is now well above the previous peak reached last summer. Some District contacts expect further increases in natural gas drilling in the Rocky Mountains in coming months, as new pipelines to areas east and to California open in the spring and summer.

Agriculture
Much of the District's farm economy continues to face drought conditions. The region's winter wheat crop has deteriorated since the previous survey, and timely rains will be needed to help develop the crop and renew pastures. Despite the drought, supplies of forage and feedstuffs have been adequate, but ranchers in some areas have been forced to pay a premium. Livestock prices have moved higher in recent months, improving profitability in the industry. Overall, District bankers report few significant problems with their farm loan portfolios. However, some highly leveraged borrowers will need to carry over or restructure their debt.

Wages and Prices
Wage and price pressures remained generally subdued across the District. Labor markets were still very slack, with little evidence of rising wages. Managers reported few problems finding workers, although some retailers and manufacturers expressed difficulties retaining quality hourly employees. The pace of layoff announcements continued to decline from recent peaks last fall. Some retail prices eased due to post-holiday discounting, although jewelry prices edged up due to recent increases in the price of gold. Retailers generally expect little change in prices in the near future. Prices for construction materials were basically flat, but some builders expect lumber and gypsum wallboard prices to increase in coming months. Manufacturers continued to report rising prices of petroleum-based products, and several firms also reported surcharges from suppliers due to increased transportation and insurance costs. At the same time, many manufacturers continued to have difficulties passing cost increases through to customers.

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Eleventh District--Dallas

From early January through mid-February, overall Eleventh District economic activity exhibited signs of inertia. Manufacturing activity remained lackluster. Service sector activity was mixed, with signs of a pickup in some industries and severe financial problems in others. Retail sales remain weak, and there is still little change in the financial services industry. Construction and real estate markets continued to decline. Energy activity picked up only mildly, despite a sharp increase in prices. Overall agricultural conditions were good.

Geopolitical uncertainties still dampen consumer and business confidence. High energy prices also weigh heavily on the outlook for some industries. Hiring is minimal, according to contacts who say investments are on hold until questions surrounding the war are resolved. Contacts report that concerns about terrorism seem to be distracting attention from normal business.

Prices
Oil prices climbed sharply in recent weeks, pushed up by continued global uncertainties in Iraq and Venezuela, along with freezing cold weather in the midwestern and northeastern United States. The prices of heating oil and gasoline have followed crude oil upward. Gasoline prices at the pump reached the highest February level on record. High gasoline prices are expected to persist into the summer; refiners would normally be building inventories of gasoline now but currently do not have the crude available to do so.

Cold weather and rising crude oil prices also pushed natural gas prices upward. Several waves of bitter weather have pulled natural gas inventories down 20 percent below year-earlier levels, and raised concerns about their adequacy to deal with a late winter blast of cold weather. Propane prices have risen along with natural gas--reaching the highest level in 13 years. Higher energy prices have pushed up chemical and plastic prices. Healthy demand for housing is driving price increases for chlorine and polyvinyl chloride (PVC).

Rising cost pressures--particularly from energy, shipping, and insurance--were noted by most industries. A few firms were able to pass along price increases, but international competition and overcapacity is making that difficult for most manufacturers and retailers. Some contacts suggest that energy price increases will be passed onto consumers if they persist. A few firms expressed concern about how long they could operate if energy costs remain elevated.

Manufacturing

Manufacturing activity remained lackluster overall. While there were some signs of pickup in the high-tech industry, demand for construction-related materials is waning. Import competition is reducing sales for some manufacturers.

Demand for fabricated metals was flat in January and February, and producers were guarded about the outlook for activity over the next year. Sales of primary metals picked up in January but then fell in February. Producers say that sales are slower than a year ago. Metals producers reported some increases in selling prices, partially passing along rising costs for scrap metal and reinforcing steel. Producers of stone, clay, and glass were surprised by better-than-expected demand over the past two months, but expressed increased uncertainty about the outlook. Paper and lumber producers report soft sales during the same period, partly because of import competition. Paper producers expect little change in sales growth because international competitors are absorbing market share, especially China.

Demand for apparel products is up. Production of private label apparel is increasing, according to contacts who say that selling prices continue to decline, even as energy prices are pushing up production costs of petroleum based fabrics.

The high-tech industry reported a slight pickup in sales since the last survey. One source of moderate improvement has been increasing orders from businesses for replacement hardware such as routers, computers, and monitors. One respondent noted that this might be the beginning of a replacement cycle; businesses remain conservative, but after so little spending in the past couple of years, feel the need to replace old equipment. Consumers continue to buy video and computer gaming systems and products, and there has been a pickup in demand for high-definition TVs and flash memory. Inventories remain very low. There is still too much capacity in the telecommunications industry, although there has been some pickup in demand for mobile phones and other consumer products. Contacts say the recent FCC decision has delayed a potential stimulus for capital investment in the industry, dampening the outlook for telecommunication equipment firms.

Refinery utilization on the Gulf Coast, which was running at about 95 percent in early December, fell to the mid-80 percent level as Venezuelan crude oil shipments were disrupted. Utilization improved slowly in early February. There have been sharp reductions in both crude and product inventories, with crude inventories 25 percent below last year and near critical levels needed to maintain normal operation of the refinery system.

Demand for petrochemicals has been generally weak over the past two months, but is still up 5 percent to 6 percent above last year. One exception is PVC, where demand has been very strong to supply the housing market and Asia.

Services

Some service firms report a pickup in activity while others fight for survival. Temporary staffing firms reported a pickup in demand over the last two months. Activity is strongest to supply administrative support, light industrial, and some professional and technical areas. Salaries are down from the levels of a year ago. Rail shipments are up over last year, with substantial increases in the shipments of metallic ores and metals.

Demand for legal services remains steady, particularly for litigation, bankruptcy, labor, and regulatory work. Real estate and lending activity are still quiet, but there are some signs of a pickup for transactional and venture capital activity. Legal contacts say activity will remain flat to moderate until corporate confidence improves. Demand for accounting and consulting activity remains solid, partly because firms continue to benefit from the Anderson fallout. The Sarbanes-Oxley bill is boosting demand for risk management and audit work.

Many small businesses are struggling, particularly those that supply the high-tech industry, and contacts say there is a huge shake out going on. One company is requiring cash up front for new business because they have depleted all reserves. This firm said they are reinventing their company regularly to find new ways to support their customers.

The airline industry remains in a tailspin. Demand for air travel continues to be extremely price sensitive, and already strapped carriers are having difficulty passing higher fuel costs on to passengers. The snowstorm on the East Coast added another financial blow. A significant drop in aircraft values has tightened the availability of credit for airlines.

Retail Sales

Retail sales continued to be weak. Although the District did not have the weather-related disruptions that occurred in other parts of the country, retailers were still generally disappointed with sales. Consumer confidence remains low, they say, and retailers are being cautious about the outlook. Contacts said that retailers are not increasing inventories and are looking for other cost-cutting measures to keep as much cash--and as much flexibility--as possible moving forward. Auto sales are down from a year ago. Dealers say that many potential buyers do not have good credit and others are waiting to buy due to geopolitical and economic uncertainty. Large rebates and low interest rate offers seem to be having less of an impact than they once did.

Financial Services

Overall lending activity continues to be stable. Real estate lending remains the strongest category, mostly for refinancing. Auto lending has dropped off since January. A few contacts reported that the quality of new loan applications has declined a bit, and there were some indications of tighter credit standards in the C&I area. Deposit growth remains strong.

Construction and Real Estate

Construction and real estate conditions continued to decline. Commercial markets are weak. Building acquisitions continue, but leasing activity is very soft, and rents are falling. Office landlords are offering numerous incentives to keep tenants and to get them to take more space. Vacancies are rising, and one contact noted that owners are obtaining reappraisals when vacancies occur, reducing their tax liability. Single family activity remains soft, with numerous foreclosures, particularly in the Dallas-Fort Worth area. Although activity is still moderately strong in the market's low end, several contacts mentioned a lack of "urgency" among buyers. Builders report an increase in incentives and downward pressure on home prices.

Energy
The domestic rig count moved over 900 for the first time since late 2001, which contacts say is a nice increase but not a discernable trend. The energy industry is not responding to much stronger prices because they view the increases as temporary and lack the trained workers to respond right away. The additional domestic projects are not very complex--oil-directed, vertical wells and on-shore. Oil service and equipment companies report that these simple drilling projects have not yet resulted in a perceptible increase in orders. The pickup in domestic activity is not offsetting a decline in international drilling.

Agriculture
Regular precipitation across the District has helped conditions overall. The livestock market conditions remain favorable. Grain prices are still low, and cattle prices are up 37 percent from last fall. Texas reported record cotton yields for 2002, up 10 percent over 2001. Rice production continues to decline, however, and contacts say "even the most efficient" dairies are doing poorly.

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Twelfth District--San Francisco

Reports from Twelfth District contacts indicate continued sluggish economic growth in much of the region during January and early February. While prices remained stable for most consumer goods and services, prices for energy and health care increased substantially. In labor markets, firms faced limited upward pressure on wages and salaries but noted continued rapid increases in costs for employee benefits. Many respondents pointed to uncertainties, due in part to geopolitical risks, as having negatively affected both consumer and business spending. Consumers appeared more cautious concerning expenditures on vehicles and travel. Conditions in District manufacturing generally remained weak with limited signs of improvement. The agricultural sector benefited from improved exports and oil and natural gas producers operated at high levels of capacity. Contacts reported continued strength in residential real estate, while commercial real estate remained weak. Bank lending continued recent patterns of rapid growth in residential mortgage loans and weak demand for business credit.

Prices and Wages
Respondents in the District reported that consumer prices generally remained stable in recent weeks. Notable exceptions were energy prices, reflecting jumps in fuel costs, and rapid increases in health-care prices. Contacts noted that retailers had very little pricing power in the face of the slow economy, extensive discounting was common among retailers and automakers.

Persistent weak demand and ample supply in labor markets continued to damp wage and salary pressures in the District in recent weeks. Contacts characterized wages as flat or up modestly. However, health care and other benefits expenses continued to increase rapidly.

Retail Trade and Services

District respondents reported that the generally sluggish economy and uncertainties related to possible military action in Iraq contributed to lackluster performance in the retail sector during the most recent survey period. Sales of new and used vehicles slowed in January and early February, both relative to December and to a year earlier. Automobile dealers noted that, with the rise in gasoline prices, inventories of SUVs and light trucks rose in several markets. Indicative of more general weakness in retail, sales of apparel reportedly were flat.

District respondents reported continued weak demand for many services in January and early February. Demand for accounting and legal services remained soft in parts of the District; in California, a large law firm catering to the technology sector closed. Transportation providers faced higher costs from rising fuel prices and uncertain future demand associated with a potential war in Iraq. Conditions in District travel and tourism were mixed. In Hawaii, for example, both domestic and international tourism continued to improve; however, the improvement was below expectations and the level of international tourism still has not recovered fully after slumping in 2001. Looking forward, District travel and hospitality industry contacts indicated that adverse effects on tourism from a potential war would more than offset any positive effects associated with the weakening value of the dollar in the foreign exchange market.

Manufacturing

Conditions in manufacturing generally remain weak in the District, with respondents noting limited improvement in January and early February. Demand conditions remained relatively stable in biotech industries, while weakness persisted in telecommunications. Respondents noted that semiconductor sales were flat to up modestly and inventories rose slightly. Capacity utilization in parts of the high-tech sector improved; utilization rates reportedly were high and, in some cases, capacity is being expanded for cutting edge technologies. Overall, however, District firms remain cautious about spending. District contacts reported that manufacturers, especially those facing rising energy costs and uncertainties related to a potential war, have postponed spending and investment decisions. Contacts also cited disruptions to businesses from the call-up of military reservists. However, several contacts noted that defense contractors in Southern California and other areas of the District would benefit from the federal government's increased spending on defense and homeland security. Several respondents reported that the fall in the value of the dollar over the past year has positioned District manufacturers to compete more effectively against foreign firms in the months ahead.

Agriculture and Resource-related Industries

The agricultural sector, on balance, benefited from increased exports, while the oil and natural gas extraction sector was marked by high capacity utilization and rising prices. Prices for specialty farm products have been mixed in recent weeks. Prices for raisin grapes fell considerably, while prices for certain nut crops were higher than they were a year ago. Respondents noted that the depreciation of the dollar contributed to higher export volumes for a variety of agricultural products, notably nut crops and beef. High levels of capacity utilization and reduced inventories in oil and natural gas production continued to put upward pressure on energy prices. Ongoing and potential disruptions of foreign energy supplies also affected energy prices.

Real Estate and Construction

Overall conditions in District real estate remained mixed, with commercial real estate markets still in a serious slump and residential markets still showing strength in recent weeks. Commercial office vacancy rates remained high and continued to edge up as leases expired. Rental rates fell, most notably in the San Francisco Bay Area, and new office construction is not expected to pick up for some time.

In contrast, contacts indicated that residential housing markets across much of the District remained robust in January and early February. Sales of low-to-median priced homes remained high in most of the District, especially in Southern California and Hawaii, although the pace of sales and of price appreciation has moderated in some areas. Throughout the District, contacts noted that markets for high-end homes had cooled off. Respondents attributed continued strength in overall home sales primarily to low mortgage interest rates.

Financial Institutions
District banking industry respondents noted strong performance among community banks in January and early February, with most depicting asset quality as remaining good. Residential mortgage loan growth rates continued to climb. Home mortgage refinancing activity was very brisk, though some lenders reported the pace of applications fell short of the pace of loan closings. Business lending remained weak.

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