The Federal Reserve Board

The BEIGE BOOK

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Summary of Commentary on Current Economic Conditions by Federal Reserve District

Summary

Prepared at the Federal Reserve Bank of Dallas and based on information collected before June 2, 2003. This document summarizes comments received from business and other contacts outside the Federal Reserve and is not a commentary on the views of Federal Reserve officials.

Although reports from the twelve Federal Reserve Districts indicated some signs of increased economic activity in April and May, conditions remained sluggish in most Districts. No District report suggested that economic conditions had deteriorated since the last Beige Book. Economic activity increased or showed signs of improving in the Dallas, Kansas City, New York, and Minneapolis Districts. The Philadelphia and Cleveland reports characterized activity as mixed, while other Districts generally saw sluggish, subpar, or subdued economic growth. The unwinding of war-related concerns appears to have provided some lift to business and consumer confidence, but most reports suggested that the effect has not been dramatic.

Consumer spending remained lackluster overall. Retail sales rebounded as the hostilities in Iraq subsided, but sales remained below the level of a year ago. Manufacturing activity was mixed, with some Districts reporting signs of improvement since the last Beige Book but others still seeing declines in orders. Service sector reports, although limited, suggested sluggish activity overall. Low mortgage rates continue to stimulate residential construction and home sales in most Districts, but commercial construction and real estate markets were still weak. The energy industry continued to strengthen. Agricultural production was impaired by wet weather in some areas. Most Districts continued to report weakness in labor markets and some downward pressure on wages, although benefit costs continued to increase.

Consumer Spending

Overall consumer spending was soft in April and May. Retail sales picked up some after subdued sales in March, but most reports indicated that sales remained below the level of a year ago. A few Districts noted that retail sales did not pick up as much as expected after the winding down of hostilities in Iraq. Wet weather was blamed for having damped sales in the Chicago, Cleveland, New York, Philadelphia, and Richmond Districts, but the very recent wet weather had a positive effect on foot traffic and sales in the Boston District. Most Districts indicated that inventories are in line with expectations, although a few Districts said inventories were on the high side, particularly apparel.

The outlook for consumer spending was described as cautiously optimistic. The Boston District reported that most contacts are less concerned about economic uncertainties than in previous months and anticipate that sales will increase modestly in the next few months. Retailers in the Richmond and Kansas City Districts also expressed optimism about sales in coming months, noting that they are planning to hire summer help. However, contacts in the Dallas and Philadelphia Districts expressed caution that sales would not pick up significantly until employment conditions improve.

Lower selling prices were reported by the Dallas, New York, and Philadelphia Districts, and widespread promotional activity and discounts were reported by the Atlanta District. The Boston and Dallas Districts noted that retailers continue to focus on ways to reduce their costs and become more efficient--using such strategies as improving their marketing, investing in faster cash registers, and increasing the use of part-time workers.

Auto sales were mixed in April and May. Sales weakened since March in the Chicago, New York, and San Francisco Districts but improved in the Atlanta, Kansas City, and Philadelphia Districts. Sales were below the level of a year ago in the Boston, Cleveland, Kansas City, Philadelphia, and St. Louis Districts. Most Districts reported that dealer inventories have risen above desired levels. Some new incentives have been added, but contacts in the Philadelphia and Cleveland Districts suggested that consumers do not appear to be as responsive to the current offers as automakers and dealers had hoped.

Manufacturing

Manufacturing activity remained mixed. Three Districts--New York, Minneapolis, and Cleveland--reported an increase in manufacturing activity in April and May although three others--Philadelphia, Richmond, and Boston--indicated deterioration since the last report. The remaining six Districts reported little change from conditions that continued to be characterized as "sluggish," "weak," "soft," or "mixed." Still, four of those Districts reported signs of improvement or optimism about future activity.

Boston, Atlanta, and Dallas noted that production related to defense and construction activity remained among the bright spots in the manufacturing sector. San Francisco noted strong demand for advanced technology production. Energy-related manufacturing activity in the Dallas District remained relatively strong.

At the same time, the Richmond District's traditional manufacturing industries--textiles and furniture--recorded particularly sharp declines in April and May. The Chicago District reported that automakers said sales of light vehicles slowed nationwide in May, and inventories remained high; Cleveland noted a sharp cutback in motor vehicle production. The Chicago and Cleveland Districts also reported that, despite an increase in demand for specialty steel, steel shipments slowed early in the second quarter. Due to limited demand for new planes by the airlines, the San Francisco District reported that production of commercial aircraft has dropped to the lowest levels since the mid-1990s.

Services

Airline traffic has steadily increased in recent weeks, according to the Dallas District but, with airline capacity abundant, expectations are for a summer with low fares and intense competition. Airlines are carrying fewer passengers than a year ago and are continuing to cut costs through additional layoffs.

The Cleveland District reported that demand for trucking and shipping was flat in May compared with April and slightly lower than one year ago. In the St. Louis District, business has picked up recently for midsize to large trucking firms because several smaller firms have gone out of business. The Dallas District reported an improved outlook for trucking companies and an increase in rail shipments. Contacts in the San Francisco District note that fears about the spread of SARS had no discernible affect on overseas shipping activity.

District reports on the temporary employment industry are mixed. In the Boston District, half of the temporary employment firms contacted reported an improvement in business in the first quarter, with demand for workers in health care and selected financial services up, but light manufacturing still weak. In the New York District, an employment agency specializing in office jobs has also seen a pickup. Temporary staffing firms in the Dallas District report that demand has steadied. However, the vast majority of temporary help industry contacts in the Chicago District said that new orders fell in recent weeks, and those in the Richmond District reported lukewarm demand for workers in recent weeks.

Reports on tourism and travel activity were also mixed. Tourism activity was soft in the Minneapolis District, declined modestly in the Richmond District, but picked up seasonally in the Boston District. In Chicago, tourism remained fairly steady, and hotel occupancy rates improved slightly in some areas. Although tourism was weaker than expected at Rocky Mountain ski resorts in the Kansas City District, summer bookings at family destinations are solid. Concerns about the SARS epidemic in East Asia reduced business and leisure travel in the San Francisco District in recent weeks. In the Atlanta and San Francisco Districts, increases in domestic tourism helped offset a decline in the number of overseas arrivals. Hotels in the Atlanta District continue to struggle because of the low volume of business travel. The Dallas District reports that hotel industry occupancy is 4 percent to 5 percent below a year ago.

Construction and Real Estate

Residential real estate markets and construction activity strengthened in the Atlanta, Chicago, Cleveland, Kansas City, New York, Philadelphia, Richmond, and St. Louis Districts and was still "solid" in the Minneapolis District. In some instances, sales growth was very strong. For example, in April and May, many homebuilders in the Cleveland District reported sales increases of more than 10 percent over the high level of sales one year ago. In some areas of the Richmond District, home sales in recent weeks displayed "unprecedented strength," including real estate agents reporting their best sales growth in more than twenty-five years. However, inventories of unsold homes in late April and May were higher than a year ago in cities in the Kansas City District and were at record levels in Denver. In the Dallas District, new home building continued to lose steam, and sales of existing homes were very weak--contacts there say that it will take new jobs and increased confidence to stimulate demand for new homes.

Overall commercial real estate continues to be weak, with only scattered indications of conditions stabilizing at a low level. The Boston District has seen high and rising office vacancy rates and falling rents. Office vacancy rates have also edged up in suburban Philadelphia. Nonetheless, both Districts reported an increase in purchases of office buildings by institutional investors and real estate investment firms. New York's office market has shown signs of improving recently, after having weakened in the first quarter. Brisk leasing activity in Lower Manhattan--largely from the health sector--pushed that area's vacancy rate down sharply to its lowest level in one year. Commercial leasing and construction activity in the Richmond District was generally flat in recent weeks, but the retail sector was one of the bright spots in recent weeks.

Banking and Finance

Lending activity continued to increase, mostly for refinancing residential mortgages. The Chicago District reports that many households appear to be taking advantage of refinancing to pay down other debt, which is limiting growth in credit card balances. Business lending increased in the Dallas, Cleveland, and Philadelphia Districts, but was weak in the Atlanta and Chicago Districts and in most of the San Francisco District. The Richmond District reports no signs of a pickup in commercial lending any time soon.

Most Districts reported little change in loan delinquencies. The Cleveland District noted a few reports that credit quality had slipped, and bankers in the Philadelphia District expect commercial loan quality to slip in the second half of the year because revenue growth for many business borrowers has been weaker-than-expected. However, the Chicago District indicated that the credit quality on commercial loans was improving modestly, while the San Francisco District reported that the credit quality of bank loans was generally stable to slightly improved. A mild increase in residential mortgage foreclosures was reported in the Atlanta District, while the Dallas District reported a May spike in home foreclosures in the Dallas-Fort Worth area. Banks in the St. Louis District reported that they had tightened lending standards for small firms.

Agriculture and Natural Resources

Wet weather delayed spring planting and other farm activity in the Atlanta, Chicago, Kansas City, Richmond, and St. Louis Districts. The heavy rains damaged crops in some areas, such as in the Richmond and St. Louis Districts, where contacts expressed concerns about reduced crop quality. But the moisture was welcomed in the Atlanta, Chicago, and Minneapolis Districts, where rainfall improved the outlook for yields. Conditions remain too dry in the Dallas District, where cotton planting was delayed because of insufficient moisture to germinate seed. The San Francisco District noted that sales were strong for beef cattle and for most crops, in part because the depreciation of the dollar boosted demand. The Atlanta District reported a bumper winter wheat crop. The Chicago and Minneapolis Districts reported that milk prices are very low.

The energy industry continues to strengthen, according to the Dallas, Kansas City, Minneapolis, and San Francisco Districts. Drilling activity picked up in response to robust demand for oil and natural gas. Contacts in the Dallas and Kansas City Districts expect drilling and related activity to continue to grow through the end of the year. The Minneapolis District reported a decline in the region's mining sector, with the closing of an iron ore mine due to financial difficulties and disruptions to production and shipments at other plants.

Labor Markets

Most District reports continued to indicate that labor markets were soft. In the Kansas City District, the pace of layoff announcements continued to ease, but layoffs continue at some large employers in the Dallas District and at some manufacturers in the St. Louis District. A few employers in Cleveland continued to report layoffs, but most indicated plans to augment or maintain their workforces. In the Atlanta District, firms are not yet hiring permanent employees but are leveraging existing staff by increasing hours and, or adding temporary personnel. In the New York District, a major employment agency specializing in office jobs reports a noticeable pickup in hiring since the last report.

District reports suggested little pressure on wages, although benefit costs continued to increase. In the Chicago District, contacts reported that many firms were instituting wage freezes and, or limiting or delaying merit increases. The Dallas District reported downward wage pressure in several industries, although some contacts said that the labor market had not eased sufficiently to allow the wage reductions they would desire. Service firms in the Boston and Dallas Districts report that downward pressure on fees has depressed pay rates. In the Kansas City District, wage pressures remained subdued, but some managers reported that their average wages had risen over the past year because lower-paid junior workers were laid off. Respondents in the San Francisco District noted very limited upward pressure on wages overall. Several Districts reported a continued rise in the cost of employee health benefits, particularly insurance.

Prices
Anecdotal reports suggest that price pressures are mixed, with no widespread inflationary or deflationary pressures. Lower prices were reported for crude oil, fuel, and some manufactured products. Prices also continue to be soft for many retail products. However, there were reports of rising cost pressures for tuition, state taxes, transportation, and all types of insurance. Natural gas prices rose, pushing up prices of most petrochemical products to record levels. The San Francisco District noted that depreciation of the dollar has led to higher costs for some imported raw materials and textiles.

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First District--Boston

The First District economy remains stalled. While retail respondents report sales meeting expectations, manufacturers, especially those producing consumer durables, cite further softening. Some staffing firms indicate demand is rising, but commercial real estate markets remain in the doldrums and software firms see little cause for optimism.

Retail
Retail contacts in New England report sales are mostly in line with expectations in April and May. Many respondents say sales were down in early March because of the war, but made a slow recovery later in the month. Some contacts indicate the very recent wet weather has positively affected sales and foot traffic.

Auto sales are said to be down slightly compared to a year ago, but better management of inventories and internal cost-cutting have raised profits. Imaging products such as digital cameras and printing materials are reportedly selling well in the office-supply sector. The seasonal pickup associated with academic graduations combined with business conventions produced strong sales for the travel and tourism sector in May.

Contacted merchants report that employment is mostly steady, with a recent rebound in the tourism sector. Wages are level, with minimal annual increases. Vendor prices are said to be stable, although a firm dependent on imports reports slight price increases because of the weaker U.S. dollar. Selling prices are mostly steady; however, there is some upward pressure. Capital budgets for 2003 are mixed, with about half reducing spending and the remaining half mostly holding spending flat.

Many respondents continue to focus on becoming more efficient, attempting to maintain lower internal costs and improve their marketing strategies. Most contacts are less concerned about economic uncertainties than in previous months and anticipate sales will increase modestly in the next few months.

Manufacturing and Related Services

First District manufacturing contacts see little if any evidence of a recovery in their sector. Makers of consumer and commercial nondurables report that current quarter sales are running below expectations and are flat to down from a year ago. Furniture makers have seen more store traffic in the last month or two, but they are divided on whether this has translated into higher sales. Aircraft and transportation-related sales remain depressed. Two companies in the semiconductor industry say their sales are up 10 percent or more from a year ago; although one characterizes business as continuing to be very good, the other says conditions are still gloomy. In contrast to general trends, defense-related business is up strongly.

Most selling prices remain flat to down. Materials costs mostly remain under control. About one-half of the sample say that they or their customers are trimming inventories or preventing further buildup. More than half are reducing employment.

Capital spending plans for the coming six to twelve months are mixed. Some companies are making large investments in more modern production technologies. Others need to restructure their operations or expand capacity in specific lines. About one-half plan to decrease capital spending or leave it unchanged. They cite factors such as ample capacity, low sales growth, and a need to preserve cash.

Manufacturers appear to be basing their expectations about the coming six to twelve months on trends for the year to date. Those that have not yet seen a pickup are inclined to believe that the economy will not turn around until 2004.

Temporary Employment

About half of responding temporary employment firms report 2003:Q1 revenues higher than those of 2002:Q1, with increases ranging from 5 percent to 20 percent. The remaining agencies' revenues were flat or down by as much as one-fourth over the same period, with some companies posting negative profits in 2003:Q1. Health-care-related employment is said to be still strong, as well as employment in selected financial services such as mortgage and insurance. Some respondents see signs of a rebound in technology employment. Contacts say employment in light industry and other manufacturing continues to be weak, facing intense competition from overseas, while traditionally stable areas of employment like academia and consumer goods have been disappointing of late.

Amidst sluggish labor demand and abundant labor supply, many respondents say client companies have pressured them to reduce bill rates, and they have reduced pay rates to maintain profit margins. Others have kept prices and wages unchanged, aiming to keep the quality of their personnel high and investing in long-term client relationships. With many companies restructuring in 2002, employment and capital spending levels in 2003 are steady.

Some contacts at temporary employment agencies are hopeful about the future, expecting revenues to be higher during the second half of 2003 than in the first half. Those who anticipate a recovery expect it to be modest and slow, and say they need to see more tangible signals before changing their strategies. Respondents express much less concern with geopolitical issues than when contacted last quarter, and more concern about rising insurance costs and the possibilities of a double-dip recession or deflation.

Commercial Real Estate
Commercial real estate markets in New England continue to perform poorly. Contacts report high and rising office vacancy rates and declining rents throughout the region. Although some respondents point out that the pace of increase in vacancy rates has slowed, there are few bright spots and no signs of recovery so far. As companies throughout the region continue to have layoffs, the demand for office space is weakening. At the same time, there is strong demand by institutional investors for office buildings, and sale prices of buildings with tenants remain high. As a result, new office construction continues, further raising the inventory of available rental space. As existing leases get closer to their expiration dates, the sublease market is diminishing in importance. Contacts expect the market to continue to deteriorate as long as layoffs continue. No turnaround is expected until 2004 or even three to five years out.

Software and Information Technology (IT) Services
The recovery of the software sector remains stalled after a disappointing January and February and a somewhat busier March and April. Less cyclical businesses such as health-care and human resources software continue to outpace the rest of the sector, which has seen little pickup attributable to economy-wide conditions. Although exchange rates have provided a modest boost to software exports, contacts say the domestic software market has not improved.

While the March pickup helped prevent imminent workforce reductions, several companies signal that they may reconsider if stagnation persists. Medical and human resource software firms, which are still adding labor, report downward revisions to their hiring targets. Further cuts in capital spending are planned or expected by wireless IT services, network software, and custom applications providers; they cite negative cash flow, low sales, and low capacity utilization as reasons for the contraction. Contacts agree that the recovery depends on aggressive increases in capital spending that they have not seen so far.

The short-term outlook remains flat and technical contacts suggest that they see no reason for the current pattern to change in the medium term. Most respondents point to mid-2004 as the earliest date for an economy-wide expansion but caution that clear signs supporting that expectation are lacking.

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Second District--New York

The Second District's economy has shown fairly widespread signs of a pickup since the last report, although businesses note diminished input price pressures. The labor market appears to be strengthening, mainly in and around New York City. Retail sales were mixed in May, with inclement weather hampering sales of seasonal merchandise. According to two separate surveys, consumer confidence improved again in May. Manufacturing activity also appears to have picked up in May.

Both home construction and the market for existing homes have been steady and fairly strong since the last report, and there are signs of a pickup in New York City's office market. Finally, bankers in the District report increased loan demand, especially for home mortgages, slight improvement in delinquency rates, and steady to slightly tighter credit standards.

Consumer Spending

Major retail chains report that sales in the District were mixed in May, with unusually cool and wet weather hampering sales of seasonal merchandise. On a comparable-store basis, sales ranged from down 4 percent from a year earlier to up 5 percent. Sales were generally described as on or above plan at department stores, but below plan at discount chains. While the weather hampered sales of seasonal merchandise--lawn and garden, swimwear, and spring apparel--most contacts indicate that overall business was better in May than in March or April.

Most retailers indicate that both selling prices and merchandise costs have declined, particularly for apparel, electronics, and lumber. Inventories are generally reported to be on the high side, but most contacts characterize them as manageable; overstocks of seasonal merchandise are expected to sell briskly once hot weather arrives. Separately, a western New York association of automobile dealers reports that vehicle sales weakened in May and characterized inventories as high and rising. As of June 1, New York State's sales tax was increased ¼ percentage point, and moderately priced clothing (under $110) is no longer exempt from sales tax; a number of counties, as well as New York City, are also increasing their sales tax rates.

Two separate surveys point to further improvement in consumer confidence in May. Siena College's monthly survey of New York State residents showed confidence rising in May for the third consecutive month. Similarly, the Conference Board reports that confidence in the Middle Atlantic states--New York, New Jersey, and Pennsylvania--rose for the second month in a row.

Construction and Real Estate

Residential real estate markets and construction activity were characterized as steady and relatively strong in May. A contact in New Jersey's homebuilding industry reports that, although adverse weather hampered housing starts in the first quarter, activity rebounded in April and May, and year-to-date construction is running on par with 2002 levels. This contact describes demand as robust, but indicates that regulatory constraints have hampered the pace of development. Separately, an Albany area homebuilder reports that May was a record-setting month for sales, reversing a slowdown in April, and also notes a lean inventory of homes on the market.

The market for existing homes has also shown signs of renewed strength. Median home prices have continued to register double-digit price gains over the past year across northern New Jersey, downstate New York, and the Albany area. However, prices across much of upstate New York were up only modestly. The number of transactions, however, has been running below 2002 levels, with some contacts attributing this to a lack of inventory.

Manhattan's co-op and condo market showed signs of renewed strength in May. A major real estate agent and a leading residential appraiser both report a pickup in sales in May, though volume was down from the exceptionally busy period a year ago. Selling prices have remained stable overall, with small apartments seeing modest price appreciation, but larger units seeing modest price declines.

New York City's office market has shown signs of improving recently, after weakening in the first quarter. In particular, brisk leasing activity in Lower Manhattan-largely from the health sector-pushed that area's vacancy rate down sharply to its lowest level in one year, though asking rents continue to run more than 20 percent below the 2000 peak levels. Midtown Manhattan's vacancy rate was little changed.

Other Business Activity
A major New York City employment agency, specializing in office jobs, reports a noticeable pickup in hiring since the last report. There has been a modest pickup in activity from the financial sector but not from the large firms. More generally, much of the recent hiring is said to be coming from small companies in a variety of industries. Also, fairly strong labor demand continues to come from the legal industry. A financial-industry contact reports that New York City's securities industry showed renewed signs of improvement in May, after a poor performance in April, and expects the higher profits to soon lead to strong gains in variable pay. However, this contact notes that the industry is seeing "massive productivity gains," driven by investments in technology, and that employment is not expected to increase noticeably in the near term.

Manufacturing industry contacts report fairly widespread improvement since the last report as well as diminishing input price pressures. Similarly, the May survey of New York City-area purchasing managers shows continued improvement in manufacturing sector conditions, though Buffalo-area purchasers report some weakening in activity. In both areas, purchasers indicate diminished price pressures.

Financial Developments
Contacts at small to medium-sized Second District banks report increased demand for all types of loans--in particular, more than 40 percent of bankers indicate higher demand for residential mortgages, compared with less than 10 percent reporting lower demand. Widespread increases in refinancing activity are also reported. Credit standards on home mortgages were unchanged, but slightly tighter credit standards were reported for other loan categories. Widespread declines in interest rates were again reported across all categories of loans and deposits. Finally, lenders report little change in delinquency rates on consumer loans but lower delinquencies on home mortgage and commercial loans.

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Third District--Philadelphia

Economic conditions in the Third District were mixed in May; some sectors improved slightly and others remained weak. Manufacturers reported continuing declines in orders and shipments. Retail sales of general merchandise picked up during the Memorial Day weekend, although sales for the month as a whole were somewhat below the year-ago level. Auto sales improved in May from April but were below the level set in May of last year. Bank lending has been rising slowly, with relatively stronger gains in residential real estate lending and slight growth in consumer and business lending. Commercial real estate market conditions remained soft, with rising vacancy rates in some markets and falling effective rents. Residential real estate sales rose in May compared with April, and house price appreciation has been strong.

Looking ahead, contacts in the Third District business community generally expect improvement in the coming months, although their views are mostly cautious. Manufacturers forecast some increases in shipments and orders during the next six months, but a significant number are considering reductions in production plans for the second half of the year compared with their earlier intentions. Retailers say the outlook is uncertain, and they do not expect significant improvement during the second half of the year. Auto dealers anticipate only a slight increase in sales from the current rate. Bankers expect continued slow growth in lending, mainly from residential real estate activity. Residential builders and real estate agents expect home sales this year to be about in line with last year's results or somewhat better, but commercial real estate agents do not anticipate any strengthening in office markets until next year.

Manufacturing

Orders and shipments at Third District manufacturing plants edged down in May compared with April, although the number of industrial firms reporting increases in new orders has risen recently and the number reporting decreases has fallen. However, the net improvement has been slight, and the trend in orders remained weak and order backlogs continued to decline. Manufacturers also continued to report declining inventories. Conditions varied among the major industry sectors in the region. Firms that make products used in residential construction reported rising orders, although some of the increase was said to be seasonal, and some makers of business and industrial equipment noted increased demand for their products. Declines in orders were reported among apparel makers, producers of basic industrial materials, and transportation equipment.

On balance, the region's manufacturers forecast improvement. Over half of the firms surveyed in May expect increases in shipments and orders, and around one in ten anticipate decreases during the next six months. Although their outlook is positive, on balance, a significant number of area manufacturers appear to be trimming their expected production rates for the second half of the year relative to the plans they had made at the beginning of the year. Around half of the firms surveyed in May said they expect production in the second half to be consistent with their earlier plans, but more than 40 percent said they might reduce production rates compared with plans, and only a few firms are considering production rates above earlier plans. Capital spending plans among area manufacturers call for increases, on balance. About one in four of the firms polled in May have scheduled higher outlays during the next six months, but the proportion of firms reporting they will reduce capital spending has risen recently, to nearly one in five of those polled in May.

Retail

Third District retailers generally reported that current dollar sales in May were below sales in May of last year, despite a pickup during the Memorial Day weekend. Retailers indicated that store traffic has improved, but their revenues were being kept in check by falling prices for many lines of merchandise as well as by cautious consumer shopping. Merchants said sales of spring apparel have increased, but sales of other seasonal merchandise have been hampered by unseasonably cold and wet weather. Store executives said they were fully stocked for the start of the summer sales season, but they were limiting inventories in light of the lackluster sales pace so far this year.

Most of the retailers contacted in May expect the second half of the year to be challenging. They said consumers are unlikely to step up spending significantly until employment conditions improve. With cautious views of sales this year, retail companies in the region have generally trimmed expansion plans for the year compared with their average rate of store openings and remodelings in the past few years.

Auto sales in the District picked up slightly in May compared with April, but dealers said sales in both months were fewer than in the same months last year. Inventories have risen above desired levels for most dealers. Some domestic manufacturers are adding new incentives, but dealers generally expect this will produce only a slight boost in sales, at best.

Finance

Outstanding loan volume at Third District banks rose slowly in April and May. Residential real estate lending continued to move up, and depository institutions and mortgage companies reported a heavy rate of applications for both refinancings and purchase mortgages. Consumer credit also continued to expand. Commercial banks in the District reported slight gains in business lending, on balance. Several commercial loan officers said they expected commercial loan quality to slip in the second half of the year, as many of their business borrowers were not achieving the revenues they had forecast.

Looking ahead, bankers in the Third District expect continued, although slow, growth in total lending. Bankers said possible further declines in interest rates might extend growth in residential lending, but they do not expect commercial lending to strengthen until business profits improve. Some bankers also said that further declines in loan interest rates will negatively affect their banks' interest margins because they cannot reduce deposit rates without experiencing deposit outflows.

Real Estate and Construction

Recent surveys by commercial real estate firms in the Third District indicated that overall office vacancy rates have edged up in suburban markets, where new buildings have recently become available, although the vacancy rate in the Philadelphia central business District has been nearly steady. Vacancy rates in suburban markets were estimated in a range of approximately 12 percent to 21 percent, up around 1 percentage point to 2 percentage points since the start of the year. The office vacancy rate in the Philadelphia central business District was recently estimated at around 13 percent, unchanged since the start of the year. Quoted rents remained fairly stable, but effective rental rates continued to decline as landlords offer tenant improvement allowances and rent-free periods. Leasing activity has been soft throughout the District, but there has been an increase in purchases of top-rated buildings in the Philadelphia central business District by real estate investment firms. Commercial real estate contacts say markets are likely to remain soft through the rest of the year, but they expect demand for space to begin growing sometime next year if economic conditions improve and area firms start to increase employment. Local commercial real estate brokers expect rents to rise, perhaps significantly, once demand for space turns up.

Residential real estate agents and home builders generally reported that sales have been running higher in May than in March and April. Price appreciation for new homes continued to be strong in many parts of the region, especially in areas where land available for development has been limited. Price appreciation for existing homes remained rapid also, as the inventory of homes for sale has declined. Real estate agents had been expecting a slight drop in sales of existing homes this year compared with last year, but the continuing decline in mortgage interest rates has led some to predict that home sales this year could match last year. Homebuilders have mixed views: some expect their sales this year to equal or exceed last year's sales, but others said their ability to increase sales will be constrained by scarcity of land and limitations on development.

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Fourth District--Cleveland

Economic activity remained mixed in the Fourth District during April and May, with some industries reporting improvements and others reporting deterioration over this period. On the positive side, most manufacturing contacts noted steady or improving production and sales, with the expectation that conditions would continue to improve in the near future. Residential homebuilders reported strong year-over-year gains in April and May (2002 was a record-sales year). Banking, for the second consecutive report, noted some improvement in commercial loan demand.

Still, some signs of weakness persisted in the economy. Retailers continued to characterize the retail environment as soft. Auto dealers reported slowing sales. Commercial builders continued to report depressed economic activity. Trucking and shipping contacts noted a downturn in activity.

Most contacts in manufacturing and residential construction expect conditions to continue improving within the next six months, although contacts in retail, trucking and shipping, and commercial construction all seemed pessimistic about prospects for the last half of the year.

The labor supply remains plentiful, and those firms that are hiring reported no difficulty in finding qualified labor. Although most firms indicated plans to maintain or augment their current workforces, a few firms did report that they planned layoffs.

Overall, prices remained stable in this reporting period. The exception appeared to be both rolled and specialty steel--prices continued to fall for these commodities in April and May.

Manufacturing
As was the case in the last report, most manufacturers noted that production and sales in May were steady or improving on both a monthly and year-over-year basis. Finished goods inventories are still lower than year-ago levels for most producers, and the level of idle capacity appears to have decreased from the last report.

Roughly one-third of our contacts noted that they were hiring, one-third noted keeping their workforce steady, and the remaining one-third reported staff reductions. Roughly half our contacts noted overtime in recent weeks. Regarding the outlook, more than half our contacts expect production and sales to increase in the near future.

Auto production fell at most plants in the District in April and May, with Districtwide production roughly 10 percent below 2002 levels, adjusting for models that moved production or were discontinued. Four of the five major auto producers in the District reported a decline in production from April to May--the declines ranged from 15 percent to 25 percent.

Demand for rolled steel softened in May, with contacts reporting production roughly 5 percent to 10 percent below April levels. Prices continued to fall, and are roughly 10 percent to 15 percent below their level at the close of 2002. Many contacts noted that they would lay-off workers if they were not constrained by labor contracts--others noted either a planned workforce reduction negotiated into next year's labor contract or temporary two-week layoffs. Contacts do not expect conditions to improve.

Specialty steel producers, however, have seen an increase in demand, and sales have increased roughly 5 percent to 10 percent from one month ago, but they are still below 2002 levels. Unlike firms in the rolled-steel industry, specialty steel producers reported either calling back laid-off employees or expanding their workforces.

Retail Sales
Retailers continued to characterize the retail environment as soft in April and May, with many contacts reporting below-plan sales and either flat or year-over-year decreases in comparable store sales. Mall traffic continues to be down, and apparel sales have been poor, in part due to the cool weather. Some contacts noted that they had hoped for a pickup in sales with the resolution of the military campaign in Iraq, but this pickup did not materialize.

Prices remained stable in May, and contacts continued to manage inventories very conservatively. Although labor is plentiful, very few contacts are hiring. Most of our contacts expected flat sales in the coming months.

Automobile dealers also noted sluggish activity. Despite some improvement in sales in early March, sales for March and April were below expectations--one contact noted sales had dropped off as much as 25 percent from the previous year. In terms of the aggressive incentives being offered, consumers do not appear to be as responsive to the current offers as automakers and dealers had hoped. Inventories at dealerships have been rising: Contacts reported inventories from near seventy-day to ninety-day supplies, well over the sixty-day supply that most dealers try to maintain. Contacts did not expect conditions to improve--most expect sales growth to remain flat through the end of the year.

Construction
Homebuilders reported strong sales in April and May, with many builders reporting sales increases of more than 10 percent over the high level of sales one year ago (2002 was a record-sales year for most of our builders)--one contact reported that April was his best month on record. The strength in homebuilding does not appear to be attributable to one or two specific housing markets; rather, it appears to be spread across the District.

Commercial builders, on the other hand, continued to report poor conditions. One contact noted that the work his firm currently has is not new business, but, rather, projects that were postponed last year. Another contact noted that lending activity appears to be constraining demand: Although some clients are interested in pursuing new building projects, the narrowing spread for lenders appears to leave them reluctant to lend money for projects.

Although activity from health-care projects has slowed some in recent months (most contacts believe it is due to consolidation in the industry), the health-care industry continues to be one of the few sources of new activity among commercial builders. School construction, which has been steady over the past two months, remains the other source of new activity in commercial construction.

Trucking and Shipping
Demand for trucking and shipping was flat in May compared with April, and slightly lower

than one year ago. Prices in the industry have remained stable over the least year, but some contacts speculate a price increase may be attempted by carriers sometime during the summer if excess capacity in the industry continues to fall at the pace it has fallen the last couple of months. The drop in excess capacity is due in part to a decision by firms to delay purchasing new engines. Many firms remain reluctant to invest large sums of money in new, unproven engines that meet the EPA regulations that took effect last October. Rather than invest in new engines, firms are making expenditures on technology to improve efficiency.

Banking
For the second consecutive report, a growing number of bankers reported slight improvement in commercial loan demand--for this report, more than half our contacts reported commercial loan demand had increased both year-over-year and year-to-date. Consumer loan conditions remained mixed: Half our contacts reported demand was slightly up, while the rest reported demand was flat or slightly down compared with one year ago.

Most bankers continued to report that growth in core deposits was either flat or slightly up. Credit standards had not changed, and the number of loan applications remained roughly the same compared with one month ago, but a few contacts did note deteriorating credit quality among applicants. Most bankers reported mortgage, installment, and business loan delinquencies were flat or very slightly increased compared with a year ago.

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Fifth District--Richmond

Economic growth in the Fifth District was subpar in the weeks since our last report as softness in the retail and manufacturing sectors persisted. Retailers reported that sales were sluggish with unusually rainy weather constraining shopper traffic in some areas. Nonetheless, retailers generally remained optimistic about sales prospects in the months ahead. District manufacturers--particularly those in the textiles and furniture industries--indicated that shipments and new orders again moved lower and that they continued to trim payrolls and hold the line on capital spending. Declining interest rates boosted mortgage lending and residential housing sales, but only slight growth was recorded in broad services sector activity. In agriculture, the incessant rainfall during May delayed planting activity and flooded crops in some areas. Although scattered reports of price declines in manufacturing were received, contacts generally indicated that prices grew modestly in most sectors of the District's economy.

Retail
Across the District, the unusually large number of rainy days in May generally weighed down store sales; contacts in the Tidewater area of Virginia, for example, told us sales were slow as did a department store in the South Carolina lowlands. A big-box discount retailer with stores throughout the District reported unchanged sales over the period, although "discretionary spending" on certain items such as electronics had fallen. But, there were scattered bright spots. The big-box contact said that despite a prolonged lull, mid-May spending on necessities rose at his stores. In addition, a department store retailer in Annapolis, Maryland, reported that their sales increased by double-digits in May because people cooped up by the weather were looking for reasons to get out of the house. District retailers were generally optimistic about sales in coming months and planned to hire summer help. A large bookstore in central North Carolina, for example, cited plans for

seasonal hiring, as did a West Virginia car dealer.

Services

Customer demand at services businesses grew modestly from mid-April through May though the experiences of individual firms varied. On the weaker side, an executive search firm in the Washington, D.C., area said business was the worst he had seen in thirty years, and a freight company in central North Carolina said customer demand had softened in May. In contrast, a sports complex in central North Carolina reported that attendance was flat, and a computer services firm in the Clarksburg, West Virginia, area reported unchanged demand. But a number of District services firms reported somewhat higher revenues. A computer firm in the Research Triangle region of North Carolina, for instance, said business had picked up recently.

Manufacturing

District manufacturing activity contracted further in April and May. Manufacturers told us that shipments, new orders, and employment were all generally lower during the period. The District's traditional manufacturing industries--textiles and furniture--recorded particularly sharp declines. A textile producer in North Carolina told us that his plant was operating only four days a week now because of poor sales. He added that he did not anticipate a pickup in new orders in the months ahead. Several plant managers voiced concern about falling prices. A furniture manufacturer in North Carolina told us that lower prices were "everywhere in the furniture industry." A plastics manufacturer in South Carolina said that he was forced to cut prices to maintain market share. Although most manufacturers remained optimistic that business would pick up in the second half of the year, they said their plans for capital spending remained on hold until they saw an increase in new orders.

Finance

District loan officers said declining mortgage interest rates pushed residential mortgage lending higher, but that commercial lending was stagnant. As conventional thirty-year fixed-rate mortgage rates dropped below 5½ percent, mortgage lending surged. A banker in Charleston, South Carolina, reported that he had all the residential mortgage business he could handle, and a counterpart in Greenville, South Carolina, told us he was "swamped" with loan applications. Commercial lenders were less sanguine, reporting that a "wait and see" attitude persisted among many of their business clients. A loan officer in Charlottesville, Virginia, noted that although there were a few signs of economic improvement in his area, businesses generally remained cautious about borrowing in the current economic environment. Several bankers in Richmond, Virginia, said they foresaw no signs of a pickup in commercial lending anytime soon.

Real Estate

Residential realtors across the District reported generally higher home sales in recent weeks. In some areas, housing markets displayed unprecedented strength. A Virginia Beach, Virginia, agent, for example, said that home sales were the best he had seen in his thirty-seven years in business. A realtor in Fredericksburg, Virginia, characterized sales there as "amazing"--the best in her twenty-seven years of experience. Although agents in Washington, D.C., Richmond, Virginia, and Greenville, South Carolina, were somewhat less upbeat, they also reported solid sales growth, particularly of low- to moderate-priced homes. District homebuilders noted that the persistent rains in April and May slowed construction activity but said that they continued to apply for a large level of building permits.

Commercial leasing and construction activity in the District was generally flat in recent weeks. Contacts reported that their clients remained hesitant to commit to real estate deals in the sluggish economy--a realtor in the Raleigh, North Carolina, area told us firms there had "no sense of urgency" to obtain additional space. The retail sector was one of the bright spots in recent weeks; retail vacancies remained low and rents held firm. "We are very upbeat [about retail]…things are headed in the right direction," remarked a realtor in Bristol, Virginia. In contrast, office leasing activity was slow and vacancy rates remained high. Industrial vacancy rates were also high and leasing activity in the sector was "very quiet."

Tourism
Tourist activity declined modestly in April and May, slowed in part by rainy weather during the period. A hotel manager in Virginia Beach, Virginia., said that business during the Memorial Day weekend was somewhat below that of a year ago, and she attributed the decrease to bad weather and heightened concerns about terrorism. She reported that her hotel was discounting rates to attract visitors. A contact at a hotel on the Outer Banks of North Carolina told us that their occupancy rate was down about 8 percent compared with last year. On a brighter note, a contact at a mountain resort in Virginia told us that his resort was completely booked during Memorial Day despite the gloomy weather.

Temporary Employment
District temporary employment agencies reported lukewarm demand for workers in recent weeks. An agent in Raleigh, North Carolina, said that although some signs of economic recovery had appeared in the area, there had not been a sustained trend toward recovery and increased hiring. Many employment agents, however, expected the economy to pick up in coming months and looked for stronger demand for their workers to follow.

Agriculture
Cooler than normal temperatures and saturated fields prevailed in most areas of the District in recent weeks, delaying spring planting activity. Hay harvesting was behind schedule in North Carolina, Virginia, and West Virginia, and the planting of peanuts and soybeans was delayed in South Carolina. Small grain crops in some areas of Virginia were damaged by winds and rain and excessive moisture. Throughout the District, crop producers expressed concerns about disease outbreaks and crop quality.

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Sixth District--Atlanta

Contacts reported that economic activity in the Sixth District remained subdued during the spring. Merchants' sales reportedly matched year-ago levels, and inventories were largely in balance. Retail sales continued to be driven by discounting and promotional activity. Contacts noted that new factory incentives led to an uptick in regional vehicle sales during May. Low mortgage interest rates continued to support the housing sector, especially in low- and mid-price markets, whereas commercial real estate markets remained weak. Reports from the travel and hospitality industry noted a modest improvement during late April and May, while most manufacturing sector contacts reported that activity remained lackluster and hiring and capital spending plans were restrained. Labor markets continued to display little sign of improvement, and employers remained reluctant to hire full-time employees. Lower fuel prices benefited District transporters, but health-care cost increases continued to adversely affect many businesses in the region.

Consumer Spending
Retail contacts reported that May sales were near year-ago levels. Most indicated that spring results were in line with expectations and that inventories were balanced. Regional consumer confidence surveys noted an improvement in consumer sentiment since the end of the Iraq war. Promotional activity and discounts remained widespread in the retail sector, particularly in apparel. Retailers anticipate that sales in the second quarter will be near last year's level. Several District car dealers reported improving vehicle sales in May. Contacts noted that factory incentives appeared to be behind the better-than-expected results. Nonetheless, most dealers reported higher-than-normal vehicle inventory levels. Used car sales continued to be weak.

Construction
Low mortgage rates continued to drive District housing markets in late April and during May. Most homebuilders reported that new home sales and construction either equaled or exceeded year-ago levels. However, some contacts noted that heavy rains across much of the District had delayed several projects in May. Reports from District real estate agents indicated that home sales during late April and May were similar to year-ago levels, with low- and mid-price segments being the strongest performers. Several contacts in south Florida noted that home sales, although still at a high level, had slowed some from the robust pace of last year. Contacts from the District's commercial real estate markets reported relatively low levels of activity in late April and during May. Vacancy rates remained high in most parts of the region and sublease space continued to put downward pressure on rental rates.

Manufacturing
Manufacturing activity remained sluggish in late spring, according to most reports. Several contacts noted that although their outlook was more optimistic, hiring and investment plans remained on hold. Some job losses were reported in the chemical industry because of higher natural gas prices, and producers of lumber and plywood reported high inventories. Pulp and paper and textile industry contacts noted low demand and a renewed focus on cost cutting. Defense-related production was characterized as "bright" by several contacts, and suppliers to the housing construction industry reported steady demand. In Alabama, plans for new facilities to supply parts to Hyundai, General Motors, and Saturn have been announced.

Tourism and Business Travel
Reports from the tourism sector were mostly positive in late April and during May. Some hotels and restaurants in south Florida reported an increase in the number of domestic travelers who had reconsidered plans to travel abroad. The increase in domestic traffic helped offset a reported decline in the number of overseas arrivals. Contacts also noted that discounting and late bookings continued to be the norm in the cruise industry. Central Florida theme parks announced summer discounts and new attractions in an attempt to increase the number of visitors. Revenues from Gulf Coast casinos were up from a year ago according to reports, and plans for a new casino in Biloxi, Mississippi, have been announced. Atlanta's hotel industry continued to struggle because of the low volume of business travel.

Banking and Finance
Responses from the financial sector were mixed in late April and May. Deposit growth at

regional banks remained moderate and nonperforming loans were at relatively low levels, according to most reports. In many parts of the District, mortgage activity was very strong, whereas corporate and commercial lending remained weak. A few reports did note a mild increase in residential foreclosures during the first quarter. Small-business loan demand remained soft overall, but a modest pickup in demand was noted in a few areas. Contacts reported continuing inactivity in local venture capital markets.

Wages and Prices
Reports suggested that firms continued to leverage existing staff by increasing hours and, or adding temporary personnel rather than hiring permanent employees in late April and during May. Some contacts observed that there was also an increase in the amount of outsourcing. Fuel prices declined during May, but other pricing trends were little changed. District trucking companies were more optimistic because of lower diesel prices. Contacts remained concerned over continuing increases in health insurance costs. Many employers were reportedly shifting some of the costs to employees.

Agriculture
Heavy rains across the District in May were welcomed by most farmers, although some fieldwork was delayed in parts of Alabama, Mississippi, and Tennessee. A bumper regional winter wheat crop boosted bulk shipments out of the Port of Brunswick.

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Seventh District--Chicago

Economic activity in the Seventh District remained sluggish in April and May. The quick end to major military operations in Iraq had not yet brought the boost in economic activity that many contacts had expected. However, most were optimistic about prospects for stronger growth in the second half of the year. Consumers and businesses remained cautious about spending in recent weeks. Housing markets were still robust, but there was little improvement in nonresidential construction and real estate activity. Manufacturing activity was again weak with few signs of strengthening. Lenders reported another surge in residential refinancing activity, while business lending was still weak. Generally sluggish economic conditions further limited increases in prices and wages. Above average rainfall delayed spring planting for many farmers, but it also helped alleviate drought-like conditions in much of the District.

Consumer Spending
Overall, consumer spending remained soft in April and May, though reports were mixed. Most retailers indicated that sales were in line with their expectations, but cooler-than-normal temperatures in much of the District may have dampened sales of seasonal items and apparel. Restaurant sales increased marginally after the war, but one contact said that sales gains were less than expected. Tourism remained fairly steady and hotel occupancy rates improved slightly in some areas. Theater ticket sales were relatively soft in April, but picked up modestly in May with the release of some highly anticipated movies. Auto dealers in the District said that new car sales weakened in May, and showroom traffic was "spotty" despite high incentives. Light vehicle inventories continued to rise and many dealers reported cutting back orders. Service and parts sales were also said to be lagging.

Business Spending

Businesses remained very cautious about their spending and hiring, even after the war. Capital spending was again weak, and there was little evidence that firms were ready to boost investment just yet. Most contacts cited slow revenue growth and a limited need to replace information technology and other equipment as the primary factors holding back capital expenditures. We continued to hear that many businesses had funds earmarked for capital outlays, but most had not yet released them. Spending on services such as advertising and business travel also remained soft. Hiring plans appeared more cautious in May. The vast majority of temporary help industry contacts said that new orders fell in recent weeks. One large firm said that year-over-year growth in billable hours, which had been slowing since the beginning of the year, turned negative in May, and an expected seasonal pickup did not occur. While softness in labor demand was broad-based, retail trade and manufacturing were said to be weaker than other industries. There appeared to be little forward-looking business spending taking place, with one contact saying that decision-makers were only spending "what was necessary to keep the lights on." At the same time, there were fewer reports that firms were planning further spending cuts.

Construction and Real Estate

Construction and real estate activity was again strong on the residential side and soft on the nonresidential side. On balance, home sales remained robust. Realtors said that the resale market was still "very active," and many continued to realize year-over-year sales increases through May. Home price appreciation, while still solidly positive, slowed in some areas. New home sales generally remained strong, though builders' reports were mixed as were contacts' expectations for home sales in coming months. Nonresidential activity remained relatively slow, but there were a few reports of modest improvement in some segments. Office vacancy rates appeared to have topped out in most areas, while rents look to have bottomed. Requests for office property showings increased in some metropolitan areas, though these had not yet translated into positive net absorption. Vacancy rates and rents for industrial properties also stabilized somewhat in April and May, and one contact suggested that industrial vacancy rates will start coming down by the end of the summer. Retail activity was also relatively stable, although a few contacts noted that the number of big box plans in the pipeline had slowed.

Manufacturing

Manufacturing activity generally was still weak in April and May. Automakers said that light vehicle sales nationwide slowed in May and inventories remained high. Heavy equipment sales remained below year-ago levels, although one industry analyst suggested that some dealers were rebuilding their rental fleet inventories, and used equipment sales were "higher than they have been in a while." Steel shipments slowed early in the second quarter after holding fairly steady in the first quarter. Gypsum wallboard production was off slightly from high levels last year. Reports from tool producers were mixed, but generally indicated relatively soft demand. One industry contact said that the number of price quote inquiries continued to rise, but this had yet to lead to an increase in orders. A leading producer of home appliances reported that an inventory adjustment by dealers led to a drop in shipments in April. However, this contact said that shipments bounced back in May and demand was firming.

Banking and Finance

Lending activity was again robust on the household side and weak on the business side. Thirty-year fixed-rate residential mortgage rates continued to fall, leading to another wave of refinancing activity. One bank reported that its mortgage applications increased by 40 percent in the last three weeks of May, with refinancing accounting for nearly 90 percent of the rise. Another suggested that many households were taking advantage of refinancing to pay down other debt, which was limiting growth in credit card volume. Standards and terms on household loans were largely unchanged, as was overall credit quality. Business lending remained weak with overall loan volumes flat. Many large businesses continued to take advantage of favorable lending conditions to refinance or restructure existing debt, and a few lenders noted some merger and acquisition activity. But demand for new investment loans was described as "lackluster" and "lacking energy." Standards and terms on commercial loans were largely unchanged, while credit quality was said to be improving modestly. Bankers suggested that the quick war brought a palpable sense of relief to many of their business customers, but a general aversion to risk persisted among many decision-makers.

Prices and Employment Costs
Generally sluggish economic conditions continued to limit upward pressure on prices and wages. Businesses noted increases in the cost of some inputs, such as energy, metals, and beef, as well as higher state tax burdens. However, contacts said that weak demand and fierce competition left them with little leverage over output prices. Producers of heavy equipment and gypsum wallboard attempted to push through price increases with limited success. But retailers and auto dealers reported using steeper discounts on more products in recent months. Upward wage pressures were virtually nonexistent in most industries. In fact, contacts reported that many firms were instituting wage freezes, and/or limiting or delaying merit increases.

Agriculture
Above-average rains in May across most of the District delayed completion of planting, forced some replanting, and shifted acres from corn to soybeans. However, recharged moisture levels have improved the outlook for both corn and soybean yields. The discovery of a single cow in Canada with "mad cow disease" disrupted cattle markets, but did not have a major impact on cattle prices. Hog prices continued to rise in May, and surpassed year-earlier levels. Dairy operations were again struggling with very low milk prices. Contacts said that low interest rates and the new tax law may release some pent-up demand for farm machinery if harvest prospects remain favorable. Renewing agricultural operating loans has become "tougher" for farmers who had low yields last year, especially if their planting was delayed this year. One contact said that federal farm program checks will help boost income, and "buffer the pain" experienced by some farmers in harder hit areas.

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Eighth District--St. Louis

With little change since the last report, economic activity in the Eighth District remains soft. Manufacturing sales declined in recent weeks compared with last year, and reports of cutbacks and plant closings continue. Retail sales were flat in April and May compared with the same months last year, but contacts are optimistic about summer sales; auto sales declined over the same period. Home sales are still up in most District areas, and commercial real estate markets remain sluggish. Over the past three months, there was essentially no change in lending activity. District farmers are concerned about crops damaged by recent storms and tornadoes.

Consumer Spending

Contacts report that spending in April and May was flat, on average, from year-earlier levels. Half of the retailers surveyed note that sales levels met their expectations, while a third of the contacts report that sales were below what they had anticipated. Jewelry, apparel, home outdoor items, and seasonal merchandise were strong sellers, while luggage, home decorative items, and gift items were moving more slowly. Despite the slow sales, more than 75 percent of retailers surveyed note that inventories are at desired levels, while less than 20 percent report excess inventory. Most contacts indicate no additional plans to discount merchandise. Expectations for the summer of 2003 remain cautiously optimistic, with about 90 percent of contacts expecting a small increase in sales from last year, and the rest expecting sales to remain flat or below 2002 levels.

Car dealers in the District report that sales in April and May were down, on average, compared with a year ago. Most contacts attribute this decline to an uncertain economy and buyers' apprehension about taking on a large amount of debt. Several car dealers report that fluctuating gas prices and low consumer confidence are causing used and low-end cars to sell better than new and high-end cars. Over half of the car dealers surveyed indicate that overall, inventories are too high. Approximately 20 percent were satisfied with their inventory levels, while the remaining 20 percent note that inventories, mostly of used cars, are too low. About 20 percent of the contacts surveyed note higher acceptance rates of finance applications, while roughly 14 percent report lower acceptance rates; the rest have seen no change. Despite sluggish sales, however, car dealers in the District remain cautiously optimistic about summer sales, expecting a moderate increase over last year.

Manufacturing and Other Business Activity

The Eighth District's manufacturing sector continues to be soft. Several contacts note that sales are low compared with last year, and some District companies have continued with plans for cutting back or ceasing plant production, while others have announced plans to do so. Affected industries include food, apparel, telecommunications, paper, furnace and air conditioning, auto parts, and tools. However, a few companies have announced plans to expand or move to the District, including some in the furniture, energy, and packaging industries. Most contacts note that capital spending plans are flat to up from last year and are primarily centered on replacing or upgrading existing capital equipment and technology.

A few contacts in the distribution and logistics industry report that business has picked up recently for midsize to large trucking firms because several smaller firms have gone out of business. The airline industry continues cost-cutting efforts, announcing additional layoffs that will affect District workers. Recent tornadoes and inclement weather in the District damaged many businesses and factories, and repairs are under way.

Real Estate and Construction

Home sales are still booming throughout the District. Compared with the same month last year, April home sales rose 23.9 percent in Memphis, Tennessee, 6.9 percent in the Little Rock, Arkansas, area; and 16 percent in northern Kentucky. April year-to-date single-family housing permits were up in most of the District's metropolitan areas compared with the same period last year. Permit levels increased 22.6 percent in Little Rock, 11.4 percent in Memphis, and 2 percent in the St. Louis area.

Commercial real estate continues to lag behind residential markets in most of the District.

During the first quarter of 2003 the industrial vacancy rate in the St. Louis area was around 8 percent, while the office vacancy rate was about 16 percent. Office vacancy rates in the Memphis area are trending up and are expected to reach 17 percent by mid-2003. Office leasing was also sluggish in Little Rock. Commercial construction has started to improve in some areas. Several new construction projects are under way in Danville, Kentucky, while March commercial permits increased considerably in Jackson, Tennessee. Construction was still stagnant in Evansville, Indiana, and continued to be slow in northeast Arkansas.

Banking and Finance

A recent survey of senior loan officers at a sample of District Banks indicates little change in the overall lending activity over the past three months. Banks' credit standards for commercial and industrial loans remained generally unchanged for large firms, but a few contacts reported slightly tightened standards for small firms. The banks that reported tightened credit standards for small firms cited reduced risk tolerance and worsening industry-specific problems as the main reasons for the change.

This survey introduced questions about the delinquency and charge-off rates over the past two quarters. Contacts cited the tightening of lending standards as the most important reason for the stabilization of delinquency rates and the low recovery rates on delinquent loans as the most important reason for the increase in charge-off rates. Credit standards for commercial real estate loans remained mostly unchanged over the past three months. Both the terms of credit and the demand for residential mortgage loans remained generally unchanged, but the demand for consumer loans decreased slightly.

Agriculture and Natural Resources
Unusually stormy wet weather throughout the District has slowed fieldwork and may necessitate replanting of corn and soybeans. Because of the rain, the fraction of soil with surplus moisture was up 81 percent from April. Corn farmers are concerned that the wet weather will continue to turn emerged corn yellow, while wheat farmers are concerned that the wet weather will damage the already heading crops. Though overall ratings have fallen since April, about 68.5 percent of winter wheat across the District is still rated in good to excellent condition. Despite the wet weather, planting is under way in most areas. District farmers have planted between 73 percent and 100 percent of their intended corn and, on average, 41 percent of soybeans and 70 percent of intended cotton. Farmers in Mississippi and Arkansas have planted more than 90 percent of their sorghum, while those in Kentucky and Illinois have planted less than 10 percent.

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Ninth District--Minneapolis

Ninth District economic activity increased slightly in late April and May. The residential real estate, manufacturing, consumer spending, energy, and agriculture sectors grew. Meanwhile, commercial real estate and mining were down, and tourism and labor markets were mixed. Overall wage and price increases were modest. Significant price increases were noted in insurance, gasoline, and tuition.

Construction and Real Estate
Commercial real estate activity was slow. Contracts awarded for large construction projects were down 10 percent for the three-month period ended in April compared with a year ago

in Minnesota, North Dakota, and South Dakota. A commercial real estate firm predicts that vacancy rates for office buildings in the Minneapolis-St. Paul area will stay at historically high levels through the rest of the year, while rents are expected to decrease slightly. Another commercial real estate firm reported that a surplus of sublease office space weighed particularly heavy on the Minneapolis and St. Paul downtown areas. The same firm also noted that the current overall market for industrial space in the Minneapolis-St. Paul area was sluggish, but that the retail market was healthy.

Homebuilding and residential real estate activity were solid. A homebuilder in Bismarck, North Dakota, noted that recent building activity was higher than a year ago. April home sales were up 8.7 percent compared with a year ago in the Minneapolis-St. Paul area. A real estate firm reported strong residential sales in Missoula, Montana. An advisory council member from the Upper Peninsula of Michigan expects sales of his manufacturing firm's bathroom fixtures to increase 5 percent for the first half of 2003 because of strength in residential homebuilding and remodeling. However, a real estate firm expects fewer permits for multiunit housing in 2003 compared with 2002 for the Minneapolis-St. Paul area, as the vacancy rate for apartments is predicted to reach 7.4 percent by year-end, up from 5.6 percent in 2002.

Consumer Spending and Tourism

Retail spending grew slightly in April and May. A major Minneapolis-based department store and discount retailer reported same-store sales in April up 3.9 percent compared with a year ago, while May sales were likely to exceed forecast. April sales were about 3 percent above last year, according to a Minneapolis mall manager, who also said that May looked good. A Montana mall manager reported April sales up 3 percent from a year ago. A North Dakota mall manager noted generally level traffic and sales in April, with increases in traffic during May.

In contrast, another mall manager in Montana reported that April sales were down about 3 percent from a year ago, and May will also finish with a decrease, as shoppers spent more on clothing but less on gifts. Indicating soft consumer confidence, a recent University of North Dakota survey showed that 54 percent of residents in a forty-mile radius of Grand Forks expect that they will do worse financially over the next year, while 36 percent expect to do better.

Recent auto sales were solid in North Dakota, according to a representative of an auto dealers association.

Spring tourism activity was soft, but the outlook for the summer season is positive. An official in South Dakota reported tourism activity down about 12 percent in April but noted strong business on Memorial Day weekend. A tourism official in northwestern Wisconsin expects a solid summer season. Upper Peninsula tourism activity in May was about the same as last year, according to an official; inquiries for the summer activity were reported down during March and April, but they picked up since mid-May. However, a major airline based in Minnesota reported that it flew 5.5 percent fewer passengers in April compared with a year ago.

Manufacturing

Manufacturing activity was up slightly. A May survey of purchasing managers by Creighton University (Omaha, Nebraska) indicated significantly increased manufacturing activity in the Dakotas and some weakness in Minnesota. As evidence, a South Dakota truck equipment producer is building an additional manufacturing plant, and an industrial manufacturer reported strong sales. Several manufacturers reported increased capital spending plans for 2003 compared with 2002. However, a lumber mill in Montana will close because of low prices and difficulty finding timber.

Energy and Mining
Activity in the energy sector increased, while the mining sector was down slightly. Mid-May District oil and natural gas exploration levels increased from early April. Meanwhile, an iron ore mine in northern Minnesota closed because of financial difficulties, and intense rains disrupted a large power plant in the Upper Peninsula, which caused two iron ore mines to shut down because of lack of electricity. In addition, flooding caused a rail bridge to shut down, which disrupted iron ore shipments. However, a Montana mining official noted that mining was stable in the state, with some potential improvement in activity later this year.

Agriculture
Agricultural economic activity increased. Heavy rainfall during May across most of the District benefited farmers and ranchers. District farmers have planted most crops, and the majority of pastures and livestock are in good to excellent condition. The calf and lamb season is essentially finished, with little loss of life reported. April meat production is up slightly from last year in South Dakota. Meanwhile, milk prices remain depressed; Minnesota and Wisconsin milk production was down in April compared with March.

Employment, Wages, and Prices
Labor markets were mixed, as companies reported a combination of layoffs and employment increases. A mining company will shut down a mine and a processing plant in northern Minnesota, affecting 450 jobs. The Minnesota Department of Transportation recently laid off 160 workers. In Sioux Falls, South Dakota, a computer manufacturer recently announced plans to lay off 75 employees. According to a bank director, companies in southwest Minnesota are generally reluctant to hire additional employees. A labor economist for the state of Minnesota noted that the pace of layoffs hasn't picked up but that layoffs are at relatively high levels. Initial claims for unemployment insurance benefits in April increased less than 1 percent in Minnesota compared with a year ago.

In contrast, a commercial cleaning and sanitizing company expects to add at least 150 jobs in downtown St. Paul over the next three years. A financial services company recently announced plans to add about forty sales staff in the Minneapolis-St. Paul area. An advisory council member expects that the demand for labor in the construction trades in the Minneapolis-St. Paul area will increase slowly into the summer.

Wage increases were modest. According to a recent survey by the *Quarterly Business Report* in St. Cloud, Minnesota, 53 percent of respondents expect to increase employment compensation over the next six months. In last year's survey, 61 percent of respondents anticipated increases in compensation. Hired agricultural workers surveyed in April in Minnesota, Wisconsin, and Michigan earned about the same level of wages as a year ago.

Overall price increases were modest, except for significant increases in insurance, gasoline, and tuition. Only 30 percent of respondents to the *Quarterly Business Report* survey in St. Cloud expect to increase prices over the next six months, down from 45 percent in last year's survey. An advisory council member reported that recent health insurance prices rose

25 percent from a year ago. As of May 19, Minnesota gasoline prices were up 9 percent compared with the same week a year earlier. Plans to raise tuition were reported by several colleges and universities in the District. For example, tuition will increase up to 19 percent at Michigan Tech University in Houghton, Michigan.

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Tenth District--Kansas City

The Tenth District economy improved slightly in late April and May, but signs of softness were still present. Retail sales edged up, residential real estate activity strengthened further, and energy activity continued to expand. In addition, the pace of layoff announcements slowed. Manufacturing activity was still sluggish, however, and commercial real estate markets remained soft. In the farm economy, recent rains eased drought conditions in some parts of the District, but further precipitation was needed. Wage and price pressures were largely subdued.

Consumer Spending
Retail sales in the District increased slightly in late April and May after slowing during the Iraq war. Despite the improvement, sales at most stores remained lower than a year ago. Among product categories, sales of home furnishings were strongest, while apparel sales were relatively weak. Most managers were optimistic that retail sales would continue to improve during the summer. Managers were generally satisfied with inventory levels, and most planned to make only small adjustments to stock levels in coming months. Motor vehicle sales strengthened somewhat in late April and May but remained lower than year-ago levels. Demand continued to be solid for new light trucks and SUVs. Dealers also reported that sales of late-model used cars had picked up. Most dealers remain optimistic that sales will continue to increase through the summer months. In the tourism industry, the Rocky Mountain ski resorts experienced a weaker-than-expected end to the ski season following strong activity earlier in the year. However, owners of family destinations in the District were optimistic about summer activity, as early bookings were solid.

Manufacturing
District manufacturing activity was sluggish in late April and May, but optimism about future activity remained relatively high. The end of the war in Iraq appeared to have little effect on factory activity. Production and new orders remained close to year-ago levels, and most firms continued to operate at medium levels of capacity utilization. On a positive note, employment levels appeared to stabilize somewhat in May, and expectations for future exports increased notably during the month. Expectations for future production and sales remained high, but plans for future hiring and capital spending were still rather muted. Over the remainder of the year, a slightly higher percentage of firms plan to increase capital spending than plan to decrease such spending, with most firms citing expected growth in sales as the primary influence on their investment decisions.

Real Estate and Construction
Residential real estate activity in the District strengthened further in late April and May, while commercial real estate activity remained soft but showed signs of stabilizing. Single-family housing starts continued to increase in most District cities, especially for lower-priced homes and townhouses. Building activity is expected to remain solid through the summer. Builders in Kansas City and Oklahoma City expect an added boost in coming

months as homeowners rebuild following destructive tornados in early May. Home sales increased in much of the District in late April and May, although inventories of unsold homes were higher than a year ago in many cities and at record levels in Denver. Most real estate agents expect home sales to remain steady in coming months. Mortgage demand remained strong throughout the District. Lenders expect the robust activity to continue, although they anticipate a shift in demand from refinancings to home purchases later in the summer. Although commercial real estate activity remained weak across the District in late April and May, it showed signs of stabilizing in most markets. Office vacancy rates and rental prices for office space were virtually unchanged from the previous survey. Most commercial real estate agents expect sales of office space to increase slightly this summer, and absorption rates are expected to edge up in some cities as well.

Banking

Bankers report that loans and deposits both edged up since the last survey, leaving loan-deposit ratios unchanged. Demand for home mortgage loans continued to grow, outweighing small declines in demand for consumer loans and business loans. Some bankers attributed the sluggish demand for business loans to a wait-and-see attitude on the part of businesses. On the deposit side, demand deposits, NOW accounts, and money market deposit accounts all edged up. All respondent banks left their prime lending rates unchanged, but a few lowered their consumer lending rates. Lending standards were unchanged.

Energy

District energy activity continued to expand in late April and May. The count of active oil and gas drilling rigs in the region rose nearly 10 percent since the previous survey, with most of the increase occurring in Wyoming. The opening of a major gas pipeline in early May relieved a capacity constraint out of southwestern Wyoming, leading to a 33 percent rise in Rocky Mountain natural gas prices and a 40 percent increase in Wyoming drilling activity by Memorial Day. Contacts expect energy prices to remain high through the rest of the year, helping sustain drilling activity.

Agriculture

In the farm economy, recent rains eased drought conditions in some parts of the District, but additional precipitation is needed for further development of crops and pastures. The moisture helped the winter wheat crop, which was reported in good condition throughout much of the District, but delayed planting of corn and soybeans in some areas. The moisture also improved pasture conditions, prompting some cattle producers to consider retaining more of their herds than they had anticipated. District bankers indicated that they had extended credit to the typical number of farm borrowers, although some bankers increased their use of government guarantees on farm loans. New-equipment sales remained sluggish, but land sales edged higher.

Wages and Prices

Wage and price pressures remained generally muted across the District. Labor markets were still very slack in late April and May, although the pace of layoff announcements continued to ease. Managers reported few problems finding workers, except for some highly skilled positions in manufacturing and health care. There were also reports that high school and college students were having difficulty finding summer jobs because of competition from laid-off adult workers. Wage pressures remained subdued, and some employers reported slower growth in health-care benefit costs. Despite the lack of wage pressures, some managers reported that their average wages had risen over the past year, as lower-paid junior workers were laid off. Retail prices were virtually unchanged from the previous survey and are expected to remain flat through the summer. Manufacturers continued to report rising prices for some petroleum-based inputs, but prices for most other materials were relatively stable. While manufacturers reported another small decline in finished goods prices, they expect output prices to rebound somewhat in coming months. As in previous surveys, prices for construction materials were flat and are expected to remain largely unchanged through the summer.

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Eleventh District--Dallas

Eleventh District economic activity showed signs of improving from mid-April through May, but the rebound is slow and inconsistent. The energy industry continues to strengthen, with growing optimism that demand will continue to pick up. The service sector is showing scattered signs of improvement. The financial services industry reported that conditions are unchanged to slightly improved. Manufacturing activity was still mixed, however, and retail sales remained weak. Construction activity continued to soften, and real estate markets remained weak. Dry conditions have hampered agricultural production.

Prices
Price pressures were mixed. Crude oil prices were sharply lower following the start of the Iraq war and then rebounded slightly. Prices for West Texas intermediate crude oil are nearly $10 per barrel lower than they were before the war, but inventories are 12 percent below last year--outside what the Department of Energy regards as a normal range. Natural gas prices rose from $5 to $6 per million Btu over the past six weeks and are expected to remain high through the rest of this year. Prices for most petrochemical products have pushed up to record levels as producers attempt to cover the high cost of natural gas and other feedstocks. Other industries reported that competition was pushing prices downward, particularly for retail products. There were widespread reports of rising cost pressures, however, particularly for transportation and all types of insurance.

Labor Markets
Layoffs continue at some large employers in the Dallas-Fort Worth area. There are reports of downward pressure on wages in several industries, but some contacts say that the labor market is still too tight to allow the wage reductions they would desire.

Manufacturing
Manufacturing activity continues to be mixed. Energy-related activity remains relatively strong, but production of other manufactured products is mostly unchanged. There were some scattered signs of improvement, but contacts say it is weak and uneven. Defense manufacturing continues to increase, although hiring has slowed.

There was little change in demand for paper products, stone, brick, glass, apparel, and food products. Demand for primary metals was also unchanged, but that was counter to the normal seasonal pickup that occurs this time of year. Demand for lumber has been slightly improving, but the industry is still reporting losses because excess capacity is eliminating pricing power.

Conditions in the high-tech sector were mixed, with some respondents reporting slightly weaker sales while others reported a slight improvement. One respondent noted that international demand has weakened because of SARS and the earthquake in Japan. Another contact noted that sales have been flat over the past three months and the expected pickup is not happening. A respondent in the semiconductor industry reported slight gains in sales and noted that growth is occurring without an increase in jobs; firms are interviewing more, however, and he expects net job growth in thirty to ninety days. Inventories remain very lean, and many products still face significant downward price pressure. Most respondents said that while they still expect a pickup over the next twelve months, businesses are still very cautious, and a significant war or terrorist event likely would have very negative effects on sales.

Refiners report that sales are flat for gasoline, down for jet fuel and very strong for residual fuel oil that can substitute for natural gas. Inventories are at the bottom of the normal range for both gasoline and distillates, and there has been little progress in refilling storage despite high levels of production by refineries.

Demand for petrochemicals was very strong in April but has cooled for a number of products in May, including for ethylene, propylene, PVC, styrene, and MTBE. Contacts gave several reasons for the slowing demand, including a weaker housing market, weak demand from Asia, and buying ahead of the Iraq war that left excess inventory.

Services
The service sector is showing scattered signs of improvement. Demand for temporary staffing has steadied, according to contacts, particularly for light industry along the Texas-Mexico border. Activity in Houston and Dallas remains fairly quiet. There is increasingly downward pressure on wages and salaries because firms say they are aware of having a larger labor supply.

Demand for legal services remained strong, especially for litigation and trial activity. Bankruptcy work, although still active, has slowed some, which contacts read as a positive sign for a recovery. Firms are also seeing some activity in transactional work, IPOs, and acquisitions. The accounting industry remained very active, with a recent increase in work for the energy industry. Wages and salaries are up 5 percent to 9 percent, and insurance costs are also skyrocketing, which is putting upward pressure on fees.

The outlook for trucking continues to improve, but higher liability insurance costs remain a concern. Rail shipments were higher than year-ago levels. Airlines report that traffic has steadily increased since the end of the war with Iraq, but expectations are for a summer with low fares and intense competition. Generally, demand has increased among leisure passengers while bookings for business travelers remain weak. SARS remains a concern. Airline capacity is still abundant, and airlines continue to seek productivity improvements to lower costs.

Hotel occupancy during the war was well below year-earlier rates, but bookings have picked up in recent weeks, partly making up for activity that was put on hold because of the war. Overall industry occupancy is still 4 percent to 5 percent below a year ago. Customers typically book rooms ninety days ahead of time, but that window has shrunk, with more people booking at the last minute.

Retail Sales
Retail sales remained soft, with most stores still reporting sales below a year ago. Although

some retailers reported slight signs of improvement, others did not. Generally disappointed that sales haven't picked up more following resolution of the war, most contacts believe weak demand results from a lack of disposable income rather than consumer confidence. Stores are relying on promotions to improve traffic. With selling prices declining, retailers continue to look for ways to reduce their expense structures, including faster cash registers and increased use of part-time workers. Some retailers reported high inventory, particularly with apparel. Automobile sales have been flat, resulting in high inventories and downward pressure on prices.

Financial Services
Conditions are unchanged to slightly improved, but conditions have improved more slowly than most contacts would hope for. Competition is stiff. Deposit growth remains relatively strong. Loan demand has been mostly unchanged, although there has been an increase in demand for commercial loans. Mortgage lending, mostly for refinancing, remains the strongest category. Auto lending remains soft.

Construction and Real Estate
Construction activity continued to soften, and real estate markets remained weak. Commercial rents and occupancy rates continue to decline. The multifamily market is still facing weak leasing demand and too much new supply. New-home building continues to lose steam, and sales of existing homes are very weak. Contacts say that it will take new jobs and increased confidence to stimulate demand for new homes. Dallas-Fort Worth area home foreclosures spiked in May but dropped off in June.

Energy
The energy industry continues to strengthen, with growing optimism that demand for oil and gas services and energy-related manufacturing will continue to pick up. The U.S. rig count has pushed up to more than 1,000 working rigs, the first time it has seen that level since late 2001. Increases are natural gas-directed and still mostly conservative, low-risk projects. Contacts say that there is still substantial excess capacity until the domestic rig count reaches about 1,200 but seemed optimistic that 1,200 to 1,300 rigs would be working in the United States by the third quarter. International drilling has also increased moderately.

Agriculture
Dry conditions have hampered agricultural production. Demand for cotton is up on world markets, but competition is stiff. Cotton planting has been delayed because there is not enough soil moisture to germinate seed. There is also insufficient moisture to make forage. After planting was delayed because of overly wet conditions, corn production is now suffering from stunted growth because of dry conditions.

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Twelfth District--San Francisco

Reports from Twelfth District contacts indicate continued sluggish economic growth from mid-April through the end of May, although there were scattered reports of modest improvement in some sectors. Prices of final goods and services exhibited little upward pressure overall, despite rising costs for some imported inputs and for employee health benefits. The winding down of hostilities in Iraq apparently did not alleviate fully consumer caution, as most retailers indicated that business was still only comparable to that before the start of hostilities. The effects of the SARS outbreak in East Asia largely were limited to the travel and tourism sector. The manufacturing sector continued to struggle with weak demand and substantial excess capacity, although sales and orders strengthened a bit for some products. District agricultural producers faced solid demand for most crops. Conditions in commercial real estate markets remained soft, while residential real estate remained vibrant in most parts of the District. Bank contacts reported weak demand for commercial and industrial loans but continued strong growth in real estate lending.

Prices and Wages

Respondents noted very limited upward pressure on prices and wages overall. Vigorous competition held prices down for most retail items, and many retail providers offered products at discounted prices during the survey period. The depreciation of the dollar has led to higher costs for some imported raw materials and textiles, but further declines in oil prices have translated into lower retail fuel prices. Except for scattered shortages of construction labor, notably in Hawaii, labor was in ample supply. As a result, wage pressures were limited throughout the District, although many employers noted a continued rise in the cost of employee health benefits and workers' compensation insurance.

Retail Trade and Services

Conditions in the retail sector were mixed, but, on net, sales appear to have improved slightly compared with the previous survey period, which included the period of major hostilities in Iraq. The winding down of hostilities in Iraq, however, apparently did not fully alleviate consumer caution, as most retailers indicated that business was still only comparable to that before the start of the war. Auto sales remained at high levels but were a little slower than during the previous survey period, and contacts noted significant inventory accumulation at dealers. Outside of autos, sales generally were described as still being a bit slow; retailers kept inventories quite lean, and their planned capital spending was flat compared with last year.

District service providers also faced mixed conditions. Demand for health services grew further, and some providers expanded capacity through new investments. However, providers of telecommunications, cable, and internet services continued to struggle with substantial excess capacity. Concerns about the SARS epidemic in East Asia reduced business and leisure travel in the District in recent weeks, although in such destinations as Hawaii and Las Vegas, weak international tourist traffic was largely offset by solid domestic tourism. Contacts also noted that fears about the spread of SARS had no discernible impact on overseas shipping activity.

Manufacturing

District manufacturers faced weak demand and substantial excess capacity in general, although a few contacts noted solid conditions or signs of improvement. Producers of the most advanced information technology products saw strong demand and have plans to expand production capacity. Most manufacturers of information technology products, however, struggled with slow sales and low capacity utilization. In the Pacific Northwest, some manufacturers of wood products and paper responded to weak demand by temporarily idling production processes. Because of limited airline demand for new planes, District production of commercial aircraft reportedly has dropped to the lowest levels since the mid-1990s. In contrast, manufacturers of construction equipment saw stepped-up demand, partly because of a seasonal pickup in construction activity. Moreover, a few firms in various industries reported plans for increased capital spending, although these plans were largely limited to replacement of aging equipment. Concerns about the spread of SARS reduced business travel and reportedly caused some disruption of overseas supply chains, such as delayed product development in apparel manufacturing, but the net impact on manufacturing was small.

Agriculture and Resource-related Industries
Overall conditions for District agricultural and resource-related businesses remained solid in the most recent survey period. Sales were strong for beef cattle and for most crops, in part because the depreciation of the dollar boosted demand. Contacts noted that demand for oil and natural gas was robust, and producers responded with further expansion of extraction capacity.

Real Estate and Construction
Conditions in District real estate markets remained sluggish on the nonresidential side but vibrant on the residential side. Vacancy rates for commercial space have been stuck at elevated levels in most areas, with little or no sign of improved demand. As a result, commercial rents were flat or slightly down, and commercial construction activity remained languid. By contrast, low interest rates reportedly spurred brisk sales of new and existing homes in most areas, driving prices and construction activity up further. Moreover, in the San Francisco Bay area, where the market for rental housing had been in a slump for the past two years, rental rates for apartments reportedly rebounded a bit during the recent survey period.

Financial Institutions
District banking contacts reported strong demand for new residential mortgages and further gains in refinancing activity for residential and commercial real estate loans. In contrast, commercial and industrial loan demand remained weak in most areas, except in Hawaii, which saw further expansion because of relatively robust economic conditions. Respondents from several parts of the District reported stable or slightly improved credit quality of bank loans. Some banks reported investment plans to replace information technology equipment.

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