



January 14, 2004

Summary of Commentary on Current Economic Conditions by Federal Reserve District

Summary

Prepared at the Federal Reserve Bank of Kansas City and based on information collected before January 6, 2004. This document summarizes comments received from businesses and other contacts outside the Federal Reserve and is not a commentary on the views of Federal Reserve officials.

Reports from Federal Reserve Districts suggest that the nation's economy has continued to improve since the last survey. The strongest report came from the San Francisco district, which said its economy expanded soundly. Most other districts also gave quite favorable reports, saying their economies improved, strengthened further, or grew at a moderate pace. However, Cleveland, Chicago, and Dallas reported only slow or modest growth, and St. Louis said conditions were mixed. Retailers and manufacturers reported that prices were generally steady despite increases for raw materials.

Holiday retail sales were generally positive across the country, and auto sales either improved or held steady in most districts. Manufacturing activity increased in nearly all districts, and New York, Philadelphia, and Kansas City noted some growth in factory employment. Housing remained strong, particularly in the Boston and San Francisco districts. Commercial real estate was still weak, although a few districts reported signs of firming. Travel and tourism activity increased considerably, and gains were reported in most other service industries as well. Bank loan demand was flat or slightly lower, with credit quality generally unchanged. Energy and agricultural activity was steady in most districts, although the appearance of mad cow disease created considerable uncertainty in the cattle industry.

Along with the increase in overall economic activity, many districts reported modest improvements in labor markets. These improvements took the form of reduced layoffs or modestly increased hiring, although new hiring was still quite minimal in several districts and most types of workers remained easy to recruit. Health care and other employee benefit costs continued to rise. However, with labor markets still slack, wage pressures remained generally subdued. Retail prices were generally flat, with some districts reporting less discounting of holiday retail prices than in previous years. Manufacturers in most districts also held their selling prices steady, despite substantial increases in the prices of some raw materials such as steel and natural gas.

Consumer Spending

Reports on holiday retail sales were generally upbeat across the country, particularly for sales during the last two weeks of 2003. San Francisco gave the strongest report, saying robust sales led to considerable year-over-year gains. Holiday sales were also quite solid in the Boston, Philadelphia, St. Louis, and Kansas City districts. Most other districts reported more modest year-over-year sales growth, although some of these districts noted an improvement in sales at the end of December. Cleveland, on the other hand, said retailers were generally disappointed by sluggish sales during the holidays. All districts reporting on store inventories said stock levels were generally in good shape for 2004, and all districts reporting on expectations for future retail sales anticipate continued improvement in the months ahead.

Looking across product categories, sales of high-end items were characterized as especially strong in several districts, including New York, Philadelphia, Atlanta, and San Francisco. Likewise, electronics and home furnishings sold well in many districts. On the other hand, sales of apparel were reported to be soft in the Philadelphia and Cleveland districts, and San Francisco noted heavy discounting at lower-priced apparel stores. Indeed, sales at discount stores in general were reported to have been below plan in several districts, including New York, Cleveland, and Kansas City.

Reports on auto sales were also generally positive, with most districts reporting either steady or improving sales at the end of the year. Cleveland, St. Louis, and Minneapolis characterized new vehicle sales as "strong" or "solid" in December, although St. Louis reported that sales of used cars were not as robust as sales of new cars. Richmond, Chicago, and San Francisco all noted some improvement in vehicle sales from previous months, while Atlanta, Kansas City, and Dallas said sales were mixed or flat. Philadelphia noted that a seasonal slowing in auto sales resulted in a buildup of inventories, and dealers in the Cleveland district were worried about their ability to sell all of their 2003 models. Otherwise, though, districts reporting expectations for auto sales were generally optimistic about 2004.

Manufacturing

Nearly all districts reported increases in manufacturing activity in December, and several districts noted that factory employment had begun to edge up as well. Chicago reported broad-based improvement across manufacturing industries, and Dallas and San Francisco said factory activity increased in a variety of sectors. Philadelphia, Richmond, and Kansas City noted strong orders in December, and Boston said several firms had been "pleasantly surprised" by recent increases in orders. Factory employment was reported to have posted modest overall gains in the New York, Philadelphia, and Kansas City districts, and factory jobs also reportedly picked up in select industries or for select occupations in the Boston, Richmond, and San Francisco districts.

Looking across industries, primary metal manufacturing was said to be improving in the Philadelphia, Cleveland, and Richmond districts, and production of various high-tech goods continued to rebound in the Boston, Dallas, and San Francisco districts due to increased capital spending by customers. Several districts also noted increases in the production of industrial machinery, building materials, and transportation equipment. On the negative side, St. Louis reported layoffs in the biotechnology, food, and tobacco industries. Petrochemical producers suffered from overcapacity in the Dallas district and continued to lay off workers in the Atlanta district. In addition, producers of paper goods in the Boston and Philadelphia districts reported some weakness.

Manufacturers across the country generally expect factory conditions to continue to improve in the months ahead, and several districts noted that capital spending in 2004 will be somewhat higher than in 2003. Much of the increased spending will go towards replacement of outdated IT and other capital equipment, but both Chicago and Kansas City reported a few firms plan plant expansions as well. Exceptions to the optimistic outlook included textile producers in the Boston and Richmond districts, who continue to suffer from excess capacity.

Real Estate and Construction

Residential real estate activity remained robust, with home sales and new construction reported to be strong in most districts. In the Boston district, home sales in Massachusetts continued to rise at double-digit rates, while housing activity in other parts of the district returned to more normal levels following boom conditions during the last two years. In the San Francisco district, home sales increased and home price appreciation remained solid. In most other districts, home sales and single-family homebuilding were reported to be holding steady at high levels. The only districts reporting some slowdown in overall housing activity were Chicago and Dallas. Contacts in the Chicago district said some easing was inevitable given the previous boom, but Dallas reported that high inventories of existing homes were becoming a concern. Both Boston and Kansas City reported that the high-end market was weaker than the entry-level market, although tentative signs of a turnaround in high-end construction were noted in Kansas City. The multifamily market remained weak in the few districts reporting on this sector, the only bright spot being a modest recovery in apartment rents in New York.

Commercial real estate activity remained weak, although there were signs of improvement in a few districts. In most districts, commercial real estate markets and nonresidential construction were described as soft with little improvement expected in the near term. Commercial builders in the Cleveland district viewed 2003 as a weak year and did not expect conditions to improve for at least the next six months. In the Chicago district, vacancy rates remained elevated in most segments of the market, and contacts saw no indication of a firming in demand at the end of the year. On a more positive note, however, a few districts reported either a pickup in activity or improvement in expectations for the future. For example, Atlanta reported that commercial construction activity was still generally weak but that leasing activity continued to improve. In the Dallas district, the office market remained soft, but contacts were increasingly optimistic that the worst was behind them. The strongest report came from the Richmond district, where contacts were highly encouraged by a pickup in leasing activity late in the year.

Tourism and Services

Travel and tourism activity improved substantially. Boston, Richmond, Minneapolis, Kansas City and San Francisco all reported a surge in visitors to ski resorts due to very good snow conditions, while Atlanta noted increased optimism about winter tourism in Florida and New Orleans. Boston also reported a positive outlook for international bookings due to the lower dollar and promotional airfares. Demand for hotel rooms in New York remained strong, as brisk leisure travel activity more than compensated for a continued slump in business travel. In other reports on business travel, Atlanta observed a modest increase in convention bookings, while Boston noted increased spending on corporate entertaining and higher bookings for corporate meetings in 2004.

Activity in other service industries generally expanded as well. Several districts reported increased demand for freight transport services. For example, Cleveland observed busy trucking activity serving retailers, Dallas reported increased rail shipments of lumber due to strength in construction, and San Francisco noted that exports and holiday imports kept several seaports operating at capacity. Looking at other sectors, Dallas reported robust growth in legal services, Philadelphia noted improved demand at marketing firms, and New York cited unusually brisk hiring for office jobs. Boston reported little change in overall demand for insurance, with slightly higher sales of long-term care products but lower revenue from large-property insurance. On a negative note, Richmond indicated lackluster activity at several business support and technical firms.

Banking

Overall demand for bank loans either remained unchanged or declined somewhat in most districts. Home mortgage lending continued to fall due mainly to lower refinancing activity. Banks in the Chicago district reported that new mortgage originations were also slowing somewhat, although such lending remained fairly strong. Demand for consumer loans fell somewhat in the New York and St. Louis districts and rose in the Philadelphia and Kansas City districts. Business loan demand increased in the Philadelphia, Richmond, and St. Louis districts but held steady or weakened in other districts. Banks in the Richmond district attributed the increased demand for business loans to the stronger economy and were optimistic about lending prospects for 2004. In the Chicago and San Francisco districts, banks reported more inquiries about lending terms from small businesses, even though overall business lending remained flat.

Credit quality and lending standards were little changed in most districts. Credit quality was described as stable in the Philadelphia district, although some banks reported higher defaults on consumer loans. Banks in the New York district reported fewer delinquencies in all loan categories except business loans. In the Chicago district, business loan quality improved, but home mortgage loan quality eroded slightly. The only changes in credit standards were in the New York district, where they were tightened slightly for non-mortgage loans, and in the Chicago district, where some large banks were said to be loosening standards on business loans in an effort to boost lending.

Natural Resources and Agriculture

Activity in natural resource industries generally held steady. Ore mining in the Minneapolis district continued at a strong pace, as some mines produced near capacity while other, previously shut, mines reopened. Energy activity in the Dallas district was little changed, but contacts noted continuing excess capacity in the oil services and machinery industry. Oil and gas drilling in the Kansas City district remained unchanged at levels considerably higher than a year ago, while Minneapolis reported a decrease in both oil and natural gas exploration. Looking ahead, natural gas producers in the Kansas City district plan increased capital spending in anticipation of continued strong production, but contacts in both the Kansas City and Dallas districts expect some decline in oil production in coming months.

While most districts reported steady conditions in the farm economy, the appearance of mad cow disease created substantial uncertainty in the cattle industry. Farm incomes were supported in the Chicago district by strong hog production and by rising corn and soybean prices, while incomes in the Kansas City district were maintained by high soybean prices and still-elevated cattle prices. In the San Francisco district, farmers benefited from strong

holiday sales of cut flowers and Christmas trees. Crop conditions in the Atlanta and Dallas districts were reported as stable. However, farmers in some parts of the Minneapolis and Kansas City districts continued to suffer from drought, and Richmond reported harvest and planting delays due to excessive precipitation. The emergence of a case of mad cow disease in Washington state resulted in a great deal of uncertainty for cattle ranchers. Contacts in several districts noted substantial declines in cattle prices due to foreign bans on U.S. beef exports. The uncertainty was causing ranchers in the Kansas City and Dallas districts to take a wait-and-see approach toward herd adjustments. San Francisco, on the other hand, reported that the appearance of mad cow disease was boosting sales of range-raised beef.

Labor Markets, Wages, and Prices

Most districts reported modest improvements in labor markets in December. San Francisco noted a pickup in hiring, Minneapolis reported more hiring announcements than layoff announcements, and Kansas City said layoffs dropped considerably. Likewise, demand for temp workers increased in the Philadelphia and Richmond districts, and Chicago said the seasonal decrease in temp employment this year was less than in the previous two years. On the other hand, hiring was said to be quite minimal in several districts. Cleveland, for example, noted that most firms still do not plan to increase payrolls in the near future. In addition, while hiring improved somewhat in the Atlanta district, firms generally remained reluctant to add full-time staff. Both Kansas City and Dallas noted some pickup in demand for high-tech workers, although such workers were still easily recruited in the Kansas City district and some types of high-tech and telecom work in the Dallas district continued to be outsourced overseas. Acute labor shortages were generally reported only for select health care fields, with some hospitals in the Atlanta district recruiting overseas to fill open nursing positions.

Wage pressures generally remained subdued throughout the nation, but most districts continued to report greater upward pressure on health care and other employee benefit costs. Chicago, Kansas City and San Francisco described wage increases as "weak" or "modest" and Boston stated that wages were mostly stable. Exceptions were reported in the Dallas district, with wages subject to downward pressure in the airline industry but upward pressure in certain occupations such as skilled mechanics. Meanwhile, districts consistently reported that employee benefit costs continued to increase. San Francisco said that the improving job market was making it harder to shift increases in health care premiums to workers, resulting in slightly higher growth of total compensation.

Most districts reported little change in final goods prices, but costs of some raw materials rose noticeably. Retail prices were generally stable. Atlanta, Kansas City, Dallas, and San Francisco all reported less discounting of holiday retail prices than in previous years, although a few other districts said holiday discounts were similar to last year. In manufacturing, the most widely cited increase in raw materials costs was for steel. Contacts in the Cleveland district said steel producers were raising prices to cover the increased cost of their own inputs, such as scrap and iron ore, and that steel prices were likely to continue rising through the first quarter. Price increases were also reported in some districts for copper and aluminum. In the Boston district, prices of lumber and plywood were reported to have fallen back somewhat from the highs reached in the third quarter, but contacts in other districts said these prices were still well above year-ago levels. In most districts, manufacturing firms were reported to still be having difficulty passing input costs on to their customers. In the Dallas district, petrochemical producers held their selling prices steady in the face of sharply rising natural gas prices, and trucking firms kept their rates unchanged

despite higher fuel costs. The only signs of a change in pricing power were in the New York and Kansas City districts, where some firming in selling prices was reported.

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First District--Boston

The economy appears to be improving in the First District. Retail activity reportedly picked up in the closing months of 2003, and travel and tourism are said to be strengthening. Demand for products of most contacted District manufacturers was higher in the fourth quarter than a year earlier. With the exception of cost increases for some metals, wood products, and oil and gas-related items, prices are generally stable or falling. Residential real estate markets in New England remain strong. Insurance activity has leveled out. Hiring plans in most sectors are modest, but contacts report no planned layoffs.

Retail and Tourism

A majority of First District retail contacts report an increase in sales, ranging from 6 percent to 15 percent, in the fourth quarter compared with prior-year sales. A furniture retailer notes a slowdown in business due to snow storms in the first half of December, but strong sales later in the month made up for the losses. According to contacts in the lumber and homebuilder sector, residential construction and home renovations continue to positively affect their business. Responding companies report that employment and wages are mostly stable. Vendor prices are generally holding steady; with the exception of lumber and plywood prices, which declined slightly after a dramatic increase in the third quarter. Inventories are in line with sales and capital spending is on target with plans, as some companies prepare to replace equipment and software in 2004.

Leisure travel has reportedly picked up in northern New England, as skiing attracted many travelers in December. Contacts note that international bookings look positive for the upcoming months, as the weak dollar attracts travelers and airlines offer promotional fares. Domestic travelers continue to favor drive-to destinations and last minute trips. Though occupancy rates in the accommodations sector have reportedly improved compared to recent months, revenues are not increasing at the same rate -- most travelers are choosing moderately priced motels with "package" deals over pricier accommodations. In the Boston area, corporate entertaining is said to have strengthened in December compared to a year earlier, and bookings for corporate meetings in early 2004 have also improved.

Most retail contacts are optimistic about 2004 and foresee continued improvements in the coming months. While some respondents are pleased by the stock market and consumers' willingness to make big-ticket purchases, they express concern about potential terrorist attacks and rising interest rates.

Manufacturing and Related Services

About two-thirds of First District manufacturing contacts report that demand in late 2004 is up from a year ago. Various firms say they have been pleasantly surprised by upticks in the fourth quarter. For example, a diversified durable goods manufacturer whose business had been "bouncing along the bottom" had a double-digit increase in orders in November. Companies making supplies and equipment for the semiconductor industry indicate that their customers' purse strings appear to be loosening. And a computer hardware firm notes improved order patterns in the fourth quarter. On the other hand, a manufacturer of office

equipment has yet to see any positive signs, and a publisher says demand for publications remains fairly sluggish.

Most selling prices remain flat to down. In some cases, manufacturers have been able to counteract downward pressures by introducing innovative products. By contrast, costs for copper and oil and gas derivatives are reportedly sharply higher than a year ago.

A biotech company is making large additions to its workforce, but most other contacts are making only modest increases or modest decreases to their U.S. headcounts. Any new hiring tends to be focused on professional and technical positions, and is often connected to new product development, sales, or support. Pay increases are expected to average 2 percent to 4 percent in 2004, about the same as in 2003.

Most manufacturers anticipate that their capital spending will be modestly higher in 2004 than in 2003. Although life sciences companies are adding to their overall capacity, most contacts' capital plans are motivated by the desire to lower the cost of production, improve maintenance of their capital stock, or change their product mix. Various contacts report that they are continuing to be cautious in their capital spending.

Manufacturing respondents are generally anticipating that revenues will increase in the coming year, but despite their increased optimism they remain uncertain about the strength or durability of the recovery. Contacts in textiles and paper products express particular concern about their sectors.

Residential Real Estate

Residential real estate markets in New England remain strong. In Massachusetts, the number of sales of both detached houses and condominiums increased by double digits in each of the past four months and the number of sales beat the previous record for the state. Prices have increased as well, although price increases have been more modest, with the average sale price rising at a rate of 7 percent to 10 percent a year.

Markets in the rest of New England have been stable; most contacts report steady prices and modestly active markets. Inventory has started to build in some areas, creating more "normal" markets, compared to extreme shortages many states experienced in the past couple of years. High-end homes, in particular, remain on the market longer, while low- and mid-priced homes sell quickly in most places. Contacts report typical seasonal slowdowns and expect that activity will pick up pace in the spring.

Insurance

Contacts indicate that overall demand for insurance has not changed much since October 2003. While demand for property and casualty insurance is still good, pricing in large property insurance has declined by as much as 10 percent as fewer risks are expected, so revenue growth from domestic sales has slowed down. Demand for life insurance remains roughly unchanged, with only long-term care products selling better than average.

While no layoffs loom in the first quarter of 2004, hiring remains subdued; however, capital budgets are beginning to expand as companies start to renew postponed capital projects. Respondents expect the first quarter of 2004 to be largely flat due to slower sales growth in the continental U.S. No major price changes are expected in 2004, in contrast to much of the past year.

Second District--New York

The Second District's economy showed further signs of strengthening in late 2003. Retailers report mixed, but moderately positive sales results for December, with a late-month surge making up for weather-related weakness in the first half of the month. While retail staffing levels were reported to be little changed from last year, hiring activity in other sectors was characterized as relatively brisk. Consumer confidence retreated slightly in December, after reaching a one-year high in November. On the other hand, business contacts indicate further improvement in manufacturing activity at year end.

Housing markets showed continued strength in the fourth quarter, and particularly in December, though new construction was hampered by harsh weather. Manhattan office vacancy rates held steady in December, while asking rents edged up further from low levels. Profits in New York City's financial industry remained strong in the fourth quarter, though off from the robust levels of the third quarter and a bit shy of expectations. Wall Street employment is said to be rising, albeit gradually, and bonuses are expected to be up 18 percent to 20 percent from last year. Finally, bankers report further weakening in demand for consumer and especially home-mortgage loans but further declines in household delinquency rates.

Consumer Spending

Retailers report mixed but moderately favorable sales results for the holiday season--late November and December. Same-store sales at major retail chains ranged from gains of 1 percent to 5 percent, compared with a year ago. For the most part, sales were above plan at the more upscale chains but somewhat below plan at discount chains. Moreover, a number of general merchandisers note a shift in the mix of sales toward higher-end merchandise. Separately, an industry survey of large and small retailers across New York State shows gains averaging 2 percent to 4 percent, which were considered a bit below plan.

After a rough start--with sales in the first half of December hampered by weekend snowstorms--the month ended on a strong note; virtually all contacts indicate brisk sales both right before and right after Christmas. Most retailers indicate that inventories ended the year in good shape, though there were scattered reports of excess stocks in certain categories. Retailers note that selling prices were steady to down modestly from last year's holiday season, and most indicate little change in peak staffing levels. Separately, based on the Conference Board's survey of Middle Atlantic (NY, NJ, PA) residents, consumer confidence retreated slightly in December, after climbing to a one-year high in November.

Construction and Real Estate

Residential real estate markets continued to show strength in the final months of 2003, while New York City's office market held steady. A contact in New Jersey's homebuilding industry reports that there has been no discernible change in the state's persistently strong housing market but that construction activity was disrupted by weather in the first half of December.

Manhattan's co-op and condo market has shown signs of strengthening: a leading appraisal firm reports that sales were brisk in the fourth quarter, particularly in December, which is typically a slow month, with a notable recovery in transactions at the very high end. Also, selling prices appear to have accelerated in December, particularly for smaller units.

Manhattan's rental market has recovered modestly in recent months, though rents are still more than 15 percent below their peak levels of late-2000. There is also a large volume of newly constructed or converted rental apartments in the pipeline.

Manhattan's office market was steady in December, with Midtown's (Class A) vacancy rate edging down from 10.8 percent to 10.6 percent but Lower Manhattan's rate rising from 13.7 percent to 14.2 percent. However, there is still a good deal of sub-lease space available, and a fair amount of new or rehabilitated office space is scheduled to come on line in 2004, more than offsetting conversions from office to residential use. Asking rents, though still well below a year earlier, continued to edge up.

Other Business Activity

A New York City employment agency, specializing in office jobs, reports that hiring activity was unusually brisk in December, which is usually a slow month. Hiring has been fairly broad-based, with encouraging strength in the financial sector, though this contact notes a persistently large number of unemployed tech workers. A contact in New York City's securities industry reports that profits retreated somewhat in the fourth quarter and, though still robust, were less than expected. Still, Wall Street bonuses are expected to be up 18 percent to 20 percent from last year; while these are typically paid out in January and February, an industry contact anticipates somewhat later payouts, on average, in 2004.

Manhattan hotels report that demand for rooms remained strong in December, for the fourth month in a row. While data on occupancy rates and room rates are not yet available, most hotels report brisk bookings. An industry contact notes that business travel remains in a slump, but that leisure travelers are more than picking up the slack.

The manufacturing sector ended the year on a positive note. Most contacts in the district report further improvement in business activity as the year ended, as well as some leveling off in selling prices, which had been declining. Similarly, Buffalo-area purchasing managers indicate an acceleration in new orders, production activity and employment, as well as slower deliveries and higher selling prices.

Financial Developments

Small to medium-sized banks in the district again report decreased demand for consumer loans and especially for home mortgages, over and beyond normal seasonal weakness. However, demand for commercial loans was little changed. Lower overall refinancing activity was reported by the vast majority of bankers.

On the supply side, bankers indicate a slight tightening of credit standards in all loan categories except residential mortgages. No bankers report an easing of standards. Interest rates for commercial loans held steady while rates for household loans were mixed: residential mortgage rates increased, on balance, while rates for consumer loans generally declined. Average deposit rates were little changed. Finally, delinquency rates again decreased for all categories of loans except commercial and industrial loans.

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Third District--Philadelphia

Business conditions in the Third District improved in December. Manufacturers reported increases in orders and shipments compared with November. Retail sales of general

merchandise for the Christmas shopping season posted solid increases compared with a year ago. Banks reported modest growth in lending, and investment companies reported continuing increases in activity. Companies in a variety of service industries gave generally positive reports, although most indicated that their business was expanding only slightly.

The consensus outlook in the Third District business community is for continued improvement in 2004. Manufacturers forecast increases in shipments and orders. Most of the retailers surveyed in December expect sales to move upward steadily in the new year. Auto dealers expect sales in 2004 to match, and perhaps slightly exceed, sales in 2003. Bankers expect modest increases in lending during the year. Service companies anticipate moderate growth.

Manufacturing

Third District manufacturers reported continuing gains in activity in December. Half of the firms polled during the month indicated that orders had increased compared with November while less than one in 10 noted decreases. Shipments increased at just under half of the firms and declined at only a very few. Although most firms said their order backlogs were steady, almost one out of five reported that their backlogs were growing. Order backlogs at area plants have been moving up at a modest, steady rate for the past several months. Business conditions were relatively stronger for firms producing industrial materials, transportation equipment, and metal products. Conditions have softened for makers of lumber products, after a relatively long period of strong activity, and for firms making a variety of paper products. While most of the firms surveyed in December reported steady employment and working hours, the number adding employees or extending hours increased noticeably during the month compared with prior months this year.

The region's manufacturers forecast continued improvement. Somewhat more than half of the firms contacted for this report expect increases in shipments and orders during the first half of 2004, and less than one out of 10 expect decreases. On balance, area manufacturing firms plan to add workers and extend work hours during the first half of 2004, and they plan to increase capital spending as well.

Retail

Third District retailers generally reported that sales for the Christmas shopping period met or slightly exceeded their expectations. On average, current dollar sales of general merchandise were up around 5 percent, with some stores reporting slightly smaller gains and a few reporting higher increases. Much of the season's sales came in the week before and after Christmas. Sales performance varied by type of merchandise. Sales of consumer electronics and home furnishings were relatively strong, but sales of apparel and jewelry were relatively weaker. Several merchants noted that more shoppers purchased higher-priced merchandise this year compared with last year, but there seemed to be less impulse buying. Store executives said price markdowns this year were about in line with past years and, in general, they were not left with excessive post-Christmas inventories. Looking ahead, most of the retailers surveyed in December expect steady sales growth in 2004 at a moderate rate.

Auto dealers reported a seasonal slowing in December that has left some with high inventories. Nevertheless, most are optimistic that sales in 2004 will at least match sales in 2003. They expect manufacturers to offer incentives as needed to keep the sales rate from slowing.

Finance

Third District banks contacted for this report generally indicated that loan volumes outstanding were increasing modestly. Business and real estate lending were on the rise at most of the banks surveyed. Most banks also reported growth in consumer lending, but the extent of the gains varied; some banks were posting fairly strong increases, but some said consumer loans were barely moving up. In general, banks indicated that credit quality has been stable. However, some noted increases in defaults on personal loans. Some banks also reported that they are reexamining the financial conditions of a number of their business borrowers, although most banks said commercial credit quality has been steady.

Bankers in the District expect moderate growth in lending to continue in 2004. They report growing optimism among their commercial borrowers, although they expect only modest increases in business activity and financing needs at firms in the region. Bankers also expect some gains in consumer lending and residential mortgage lending during the year.

Investment companies in the District have seen stepped up activity in the past few months. Inflows to equity funds have increased markedly while inflows into bond funds have been steady. Mutual funds and stock brokerages expect growth in activity in 2004, although they anticipate increases in costs if new regulations on trading activity are imposed.

Services

Service firms contacted in December generally reported slight strengthening in growth compared with prior months. Demand for general business services has edged up, and firms involved in various marketing functions also noted some recent improvement after a prolonged slow period. Information technology service companies also reported some stronger growth, with much of their new business related to systems integration and network security needs. Employment agencies indicated that both seasonal and fundamental demand for temporary workers has picked up. Reports on permanent hiring were mixed. On balance, the pace of hiring was just edging up, with relatively stronger demand for employees in the service, finance, and transportation industries. Looking ahead, most service companies expect moderate growth in 2004, with some building of momentum as the year progresses.

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Fourth District--Cleveland

The economic environment remained relatively unchanged in recent months, as the slow and steady improvement in business conditions that marked the September-October period continued in November and December. Most manufacturers indicated that production levels stayed at least steady in the last two months of 2003. And while retailers expressed disappointment at sluggish holiday sales, sales levels, nevertheless, inched up as the year ended. Conditions in the construction industry seemed largely unchanged as well, as residential builders saw demand stay strong, and commercial builders continued to wait for demand conditions to improve. Shipping firms saw a pick-up in activity that began in the late summer continue, while banks reported mixed loan demand and a slowing in the rate of core deposit growth.

As in reports of recent months, most firms indicated that they do not plan to increase staffing levels. Unlike in recent months, however, reports of rising input prices seemed more widespread.

Manufacturing

Durable goods producers, in general, reported that production levels remained steady in November and December, continuing the pattern of the last several months. Relative to a year ago at this time, durable goods production in the District appears to have increased slightly. Nondurable goods producers saw slightly higher levels of production in November and December than in September and October and also reported increases in production relative to the November-December period in 2002.

Durable and nondurable goods producers alike reported lower inventory levels than at this time a year ago, and most indicated that inventories were at acceptable levels. The use of overtime was also widespread among both durable and nondurable goods producers, though neither group at this point reported plans to expand their employment rolls. In fact, about half of the durable goods producers contacted said they plan to trim their workforces in the near future. Rising input prices--over the last year and last several months--were also reported by a majority of respondents in the manufacturing sector. Durable goods producers in particular indicated increases in metals prices, notably steel and aluminum.

An increasing number of contacts in the domestic steel industry reported rising new orders in recent weeks, a decided difference from the previous few months. Reports suggested steady demand from automotive and appliance makers and improving demand among industrial equipment producers and truck and trailer manufacturers. Lead times at steel mills are reportedly on the rise, and some respondents indicated that their order books were full through the end of the first quarter. Accordingly, a few respondents indicated that factory utilization was rising to accommodate the robust demand. While some firms increased work schedules slightly in response to the increase in demand, many firms have maintained normal work schedules and do not plan to add to their workforce. Prices for both flat-rolled and structural steel have continued to rise in recent weeks, as mills attempt to offset the rising costs of raw materials such as scrap, iron ore, coal, and natural gas. Steel prices to noncontract customers have increased over the last six weeks and, according to contacts, could continue to increase through the first quarter.

For the November-December period, the District automobile plants that we track saw a slight increase in production relative to the same period a year ago. However, of the five major automakers with facilities in the District, two saw significant gains in production on a year-over-year basis, which masked moderate declines in production for the remaining three.

Retail Sales

In general, District retailers reported less robust sales activity in November and December than they had anticipated. After expressing optimism at the time of the last report about the coming holiday selling season, many retailers reported that their sales had not met expectations. Responses from contacts at specialty retailers ranged from those who cited soft sales to those who indicated modestly increasing sales from a year ago. Most contacts at discount stores reported lower-than-expected sales gains. Finally, department stores in the District continued to fare worse than other types of retailers, citing year-over-year sales declines. While apparel sales remain soft, contacts continued to note that furniture and other consumer durables were selling well, as were electronics, novelty gifts, and personal care items.

Several contacts reported increases in promotional activity over the last six weeks of 2003, through temporary price reductions or coupons. Price reductions for apparel items were especially prominent. Nevertheless, many retailers also reported that their promotions were no more aggressive this year than last. In general, input prices remain flat. Inventories are reported to be flat or down relative to this time a year ago and continue to be tightly managed.

New car sales were reported to be strong at the end of December, and up from the levels in November and at this time last year. Contacts reported that strong incentives continue to attract car buyers. Inventories, however, remain large, and some dealerships reported that they are concerned about their ability to sell enough of their older stock before the end of the model year. Used cars sales remained steady for dealers in the six weeks ending 2003.

Construction

Residential builders reported that activity slowed somewhat in the last two months of 2003, though most of this slowing was attributed to seasonality. Nevertheless, sales levels were strong, and similar to those at this time last year. Most builders saw stronger sales in 2003 than in 2002, and several expect 2004 to be better still. A few larger builders also noted an improvement in their profit margins in 2003, driven largely by lower costs. Cost pressures, in general, remain muted. Although lumber, oriented strand board, and plywood costs remain high, they have not risen recently.

Commercial builders reported little improvement in conditions in November and December from previous months. And, relative to the last two months of 2002, about as many builders saw more activity in the last two months of 2003 as saw less. In general, 2003 was a weak year for commercial construction in the District, and most contacts don't expect conditions to change significantly for at least six months into 2004. In general, labor and materials costs remained steady.

Trucking and Shipping

After increasing in the fall, trucking and shipping activity in the District remained robust at the end of 2003 and outpaced the levels of activity at the end of 2002. Contacts reported that most of the strength in demand was attributable to clients in the retail sector. Despite strong demand, some firms reported that their amount of activity was below expectations, though others reported operating at almost full capacity.

Carriers cited concerns about new EPA regulations regarding engine performance, recent increases in insurance costs, and new hours-of-service regulations that all could add significantly to costs. Fuel costs, however, have so far remained stable.

Banking

Commercial loan demand remained mixed across the District's banks during the six weeks ending 2003. Consumer loan demand also continued to weaken, as the number of mortgage refinancings that banks brokered fell further. Core deposits grew only modestly for most contacts, while a few contacts reported no growth in core deposits. Some contacts reported an improvement in their institution's net interest margin.

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Fifth District--Richmond

Overview

The Fifth District economy expanded at a moderate rate in November and December, led by continued signs of a rebound in manufacturing activity. Manufacturers reported solid gains in shipments and December new orders posted their strongest increase in over a year. District retailers recorded generally steady sales growth through the holidays while services firms said their revenues increased only slightly. In real estate markets, residential activity remained upbeat and commercial leasing activity picked up during the final two months of 2003. District bankers noted somewhat higher demand for commercial loans but said that slower refinancing activity put a lid on residential mortgage lending. Tourism was strong, with special events and an encouraging start to the ski season supporting activity. In agriculture, excessive precipitation hampered field work and limited small grain planting.

Retail

Overall, retailers in the Fifth District experienced steady sales growth over the holiday season, with sales generally meeting projections. A discount store in Chesapeake, Va., reported strong customer traffic and revenue growth in December in part because area competitors held off price cuts until just a few days before Christmas. Hardware and lumber stores in Columbia, S.C., and Richmond, Va., reported that their sales grew modestly. But not all stores posted gains. Contacts at a department store and a large bookstore in textile-dependent central North Carolina said they met their sales goals, but added that they had set their revenue targets somewhat below year-ago levels. Most automobile dealers in the District said that sales grew moderately and they looked for a pickup in automobile sales in coming months, leading some dealerships to increase hiring.

Services

District services firms said customer demand grew only slightly in November and December. Despite heightened terror threats, District airports reported strong passenger traffic in November and December. In addition, a Baltimore, Md., financial services firm said customer demand remained positive and they were hiring. But several professional, scientific, and technical services firms reported that their business had flattened toward year-end, as did an administrative and support services firm in lower Maryland. Adding to the lackluster tone, freight transportation operations in North Carolina and Maryland said that demand was essentially unchanged from six weeks earlier.

Manufacturing

District manufacturing activity grew at a solid pace in November and December, led by modest growth in shipments and a strong increase in new orders. New orders increased notably in December, especially at primary metal and industrial machinery manufacturers. An electronics equipment manufacturer in Maryland told us that while his shipments were nearly flat in December, new orders picked up and several of his customers had asked for expedited delivery in the months ahead. A North Carolina boat manufacturer reported increased sales and suggested that a "better economy" was boosting the demand for boats, leading him to expand hiring. In contrast, apparel and textile manufacturers saw few signs of firming in recent months. Contacts in these industries said they continued to lose market share to Far East producers and several noted that they would trim capital spending further in 2004 because of reduced sales, lower capacity utilization and poor cash flow.

Finance

District bankers reported negligible loan growth in November and December as softness in

residential mortgage refinancing largely offset modestly higher commercial lending. Although mortgage lending for new purchases was steady, residential mortgage refinancing dwindled; a banker in Richmond, Va., said the "refinancing boom was gone," adding that 30-year mortgage rates would have to drop below 5-3/4 percent to spark another round of refinancings. On a brighter note, contacts said demand for commercial loans rose. A Charlottesville, Va., lender said commercial lending had been stoked in recent weeks as local economic conditions strengthened and area retailers netted higher sales. Most financial contacts expressed optimism regarding lending prospects for 2004; a Richmond, Va., banker, for example, expected commercial lending to grow by 7 percent in the upcoming year.

Real Estate

The pace of residential real estate activity remained generally strong since our last report, although the holidays damped buyer traffic somewhat. A real estate agent in Fredericksburg, Va., described the market there as "incredible" and "across-the-board-good" while an agent on Virginia's Eastern Shore said that housing demand was "pretty hot right now." A realtor in Odenton, Md., said that houses were staying on the market a little longer and some closings were being put off until after the holidays, but she expected sales to be "wild" again in January. An agent in Fairfax, Va., was less upbeat, however, noting that sales growth there had trailed off in recent months though the level of activity remained high. Home prices were reported to be generally flat across the District.

According to commercial realtors, leasing activity in the Fifth District picked up over the final two months of 2003. "Conditions are surprisingly good here--the year finished with a flurry," noted a contact in Columbia, S.C., where leasing activity in office, retail, and industrial space was strengthening notably. Activity was also on the upswing in Charlotte, N.C., where a realtor reported increased interest in industrial space. Strong conditions continued in the Washington, D.C., and Richmond, Va., retail markets--the Washington, D.C., contact was "pretty upbeat" about leasing activity and a Richmond realtor reported "smooth sailing" over the past two months. Overall, rents held firm and vacancies were down slightly across the District.

Tourism

Tourist activity strengthened in the District in late November and December. Celebratory events associated with the First Flight Centennial in Kitty Hawk, N.C., boosted tourism on North Carolina's Outer Banks in mid-December. In Myrtle Beach, S.C., tourism received a lift as military personnel began to return from Iraq. Contacts at several ski resorts in western areas of the District said that holiday bookings in December set records. A Virginia ski resort operator reported that heightened concerns over airline safety since December 21 had generated increased business while his counterpart at a resort in West Virginia credited ample snowfall for the increase in activity there.

Temporary Employment

Contacts at temporary employment agencies in the District generally reported modest increases in the demand for workers since our last report, and most expected continued increases in demand in the coming year. An agent in Raleigh, N.C., said he was seeing strong demand for sales representatives, accountants, and engineers, adding that all indications pointed to even stronger hiring of temporary workers in 2004. And an agent in Gastonia, N.C., also expected stronger demand for placements over the next few weeks citing more spending by consumers and a brighter economic outlook.

Agriculture

Excessive precipitation since our last report hampered field work and limited small grain planting activity in many areas of the District. Farmers in North Carolina made only slight progress in harvesting cotton and soybeans because of the rainfall. Soybean harvesting was behind schedule in Maryland as well. Many field activities were delayed in Virginia and West Virginia because of severe flooding in late November. On a brighter note, cotton and soybean harvesting was nearing completion in South Carolina and the apple harvest was finished in Virginia.

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Sixth District--Atlanta

Summary

Reports from the Sixth District indicated that the pace of economic growth remained favorable during November and December. District retailers gave encouraging early reports on holiday sales and most contacts noted that activity met or exceeded year-ago levels. Auto sales were mixed, with foreign models outperforming domestic brands. Strength in the District's residential housing markets continued, whereas commercial construction remained generally weak. Reports noted modest improvement in the industrial sector, and some contacts reported an increase in capital spending during November and December. The District's tourism and hospitality sector continued to improve late in the year. Responses from the financial sector were also mostly positive. Labor market reports firmed a bit in November and December, although employers remained cautious. Prices were described as stable overall.

Consumer Spending

Initial reports from District retailers indicated that holiday sales met or exceeded year-ago levels. Contacts noted that the combination of lean inventories and strong sales resulted in fewer discounts than in recent years. In particular, less discounting was noted after Christmas. Several contacts reported that high-end merchandise did well over the holiday season. Electronics and home-related products were also strong sellers. Generally, retailers were upbeat about their prospects for first-quarter sales.

Vehicle sales in November and December were mixed, according to reports from auto dealers. Some contacts noted that December is traditionally a low-volume month, although foreign model sales were quite strong late in the year. Most contacts reported that a reduction in the level of incentives had not significantly reduced sales or floor traffic at dealerships.

Real Estate

District single-family housing markets ended the year strongly, with both construction and sales continuing at a steady pace. Commercial markets were mixed. Commercial construction remained generally weak in November and December, while leasing activity continued to improve. Local industry analysts reported that improvements in the commercial real estate market were expected in 2004.

Manufacturing and Transportation

District contacts reported that manufacturing production continued to recover in November and December, and industrial energy sales had stabilized in some parts the District. Some

contacts noted that previously delayed capital spending plans have been revived, especially IT equipment and infrastructure. Reports cited increased confidence in the sustainability of economic growth, tax law changes, and the need to replace outdated and worn equipment as reasons for the pickup in capital spending. Auto parts producers continued to announce plans for new plants, and tractor and trailer producers reported increasing orders over last year. New military contracts boosted activity for shipyards and military equipment suppliers. Less positively, Louisiana's petrochemical industry continued to pare employment rolls.

District trucking contacts continued to report gains in seasonal freight demand late in the year. Airfreight tonnage improved from year-earlier levels for both domestic and international cargo in Atlanta and Miami.

Tourism and Business Travel

The District's tourism and hospitality industry continued to improve at year-end. In Miami, restaurants were said to be hiring aggressively, and south and central Florida tourism officials were upbeat about the current tourist season. Tennessee hotel occupancy rates were picking up in November and December from a year earlier as well. New Orleans tourism industry officials were upbeat about the first half of 2004, and Atlanta contacts reported a modest increase in convention bookings for 2004.

Banking and Finance

Responses from the financial sector were mostly positive. Deposit growth held steady or improved in much of the region from a year ago. Commercial loan demand, however, remained weak. Credit quality continued to strengthen and past due loans at banks were below year-ago levels. Most banks were reported to be moving ahead with capital expenditures to improve operating efficiency.

Employment and Prices

Reports on hiring were more positive in November and December than in previous reports, but employers continued to be cautious regarding adding full-time staff. Several businesses reported that they were keeping a lid on current payrolls but were increasing the amount of outsourcing. In south Florida, seasonal hiring was reportedly stronger than it has been for several years. Hospitals throughout the District continued to recruit internationally to help meet the nursing shortage.

Most reports indicated that businesses were not raising prices. But one report did note that increases in raw material costs were being passed on to customers, whereas wage and benefit increases were not being passed on. Prices for timber products remained high because of relatively low supplies and strong housing construction activity in the District.

Agriculture

Conditions remained mostly favorable for the District's crops. The harvest of sugar cane, citrus crops and vegetables was underway in some areas. The discovery of mad cow disease in Washington was expected to have an effect on the region's economy through lower cattle prices.

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Seventh District--Chicago

Summary

Seventh District economic activity continued to improve modestly in late November and December. On average, consumer spending picked up modestly, driven by a surge in buying during the last few days of the year. Business spending also increased modestly. Construction and real estate activity slowed somewhat. The manufacturing sector continued to pick up, and the improvement was broad based. Overall lending activity was relatively flat at the end of the year. Upward retail price pressures remained generally subdued, while reports of increasing input costs became more frequent. Cattle prices fell significantly on mad cow concerns, but remained above year-ago levels. Meanwhile, corn and soybean prices rose in December, partly due to improved export prospects.

Consumer spending

Overall consumer spending picked up modestly in late November and December. Retailers reported that holiday sales results were somewhat stronger than a year ago, and were generally in line with their expectations. Sales were particularly robust during post-Christmas promotions, as consumers snapped up deeply discounted merchandise and redeemed gift certificates. District auto sales showed a similar pattern, as dealers reported a flurry of sales in the last few days of December. One contact with a regional theater chain indicated that movie ticket sales also improved markedly toward the end of the month. By contrast, casual dining sales were said to be flat. Tourism and travel-related spending picked up modestly, and was slightly ahead of a year ago. Many contacts expect tourism and travel spending to accelerate in 2004 with a general improvement in overall economic activity.

Business spending

Business spending continued to increase as 2003 drew to a close, but the gains were generally modest. Many businesses continued to repair and replace existing equipment, but there were few reports of capital expansion. Temporary help firms noted that the number of workers on assignment showed a seasonal decrease, but the decline was not as pronounced as in the previous two years. One contact also said that average hours per assignment, which typically fall toward the end of the year, held firm in December. Business contacts were increasingly confident that demand will continue to firm in 2004, and many have boosted their hiring and capital spending plans.

Construction/real estate

Overall construction and real estate activity appeared to moderate in December. On the residential side, builders and realtors noted that property showings and sales softened toward the end of the year, though the level of activity remained strong. At least part of the slowdown was attributed to the onset of winter weather. But contacts also said that some moderation was inevitable after exceptional housing market strength in the summer and fall. Still, builders and realtors expect that low mortgage interest rates and an improving job market will buoy home sales in 2004. Nonresidential construction and real estate activity changed little from our previous report. Vacancies remained elevated in most commercial segments and rents were still depressed. Contacts said there was little indication that demand for commercial properties had firmed at the end of the year, but December is not typically an active month for property inquiries.

Manufacturing

District manufacturing activity continued to improve moderately in December, and the improvement appeared to be widespread. According to contacts, a wide array of

manufacturing firms boosted production to meet increasing demand. Manufacturers' inventories remained very lean and there was little evidence that firms were rebuilding stocks in December. However, with strong new orders, low inventories, and improving earnings, contacts were confident that the recovery in manufacturing would continue to gain momentum in 2004. Manufacturers of consumer goods said that demand should hold at high levels, while producers of capital equipment expected the equipment replacement cycle to pick up steam.

Banking/finance

On balance, overall lending activity was fairly flat. On the consumer side, mortgage applications in December remained well below levels reached earlier in 2003. Refinancing activity has dropped off considerably, and while still fairly strong, new mortgage originations have slowed somewhat. One lender said that margins on mortgage loans continued to tighten through the end of the year. This lender also noted that household loan quality eroded slightly in December, particularly in the bank's mortgage portfolio. On balance, business loan volumes were again flat, although some banks reported increasing inquiries, particularly from small firms. Furthermore, as several lenders pointed out, business borrowing typically slows toward the end of the year. Business loan quality continued to improve modestly. One contact said that a few large banks were loosening standards on business loans in order to boost lending.

Prices/costs

Upward retail price pressures remained largely subdued, while reports of rising input costs increased. Retailers said that intense competition and value-conscious consumers combined to keep a lid on price increases. More manufacturers, meanwhile, reported rising input costs, flat output prices, and narrower margins. Contacts specifically cited increasing energy, insurance, and employee benefits costs. One contact said that steel prices continued to rise, despite the government's recent decision to drop import tariffs. Wage gains remained relatively weak.

Agriculture

After rising to record levels during the fall, cattle prices dropped substantially following the discovery of a single cow with mad cow disease on the West Coast. Cattle prices have since stabilized and remained above year-ago levels, but much uncertainty persists. Some industry analysts said that import bans by key trading partners will curb demand for the District's high-quality beef. Milk production picked up nationally, pushing prices down further. Hog production remained strong, as packers sought to keep profitable lines running. Corn and soybean prices rose in December as export prospects improved. Drought conditions receded in western portions of the District, though some areas still need a lot more moisture by spring for the new crop year.

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Eighth District--St. Louis

Business conditions in the Eighth District were mixed at the end of 2003. Some contacts in manufacturing and services reported improved employment and investment conditions, while other contacts in manufacturing and services reported layoffs, plant closings, and flat or reduced capital spending. Retail and auto sales increased in November and December compared with the same months of 2002. Home sales were still up in most of the District,

but commercial real estate markets continued to be slack. Loan demand at a sample of small and mid-sized banks declined slightly between early September and early December.

Manufacturing and Other Business Activity

Business activity in the Eighth District experienced mixed conditions since our last report. Some manufacturing contacts reported increased employment, facility expansions, and increased capital spending, while others reported decreased employment, facility consolidations, and flat or decreased capital spending. Plant openings and expansions were concentrated in the building materials, automobile, and auto parts industries. In contrast, firms in the biotechnology, food processing, and tobacco industries announced plant closings and cutbacks. In the services sector, contacts in the health care and banking industries announced plant openings and expansions. A District hospital reported they would add additional acute-care beds and would hire new employees. In contrast, a major airline announced that it would close its call center, eliminating additional jobs in the District.

General retailers reported increased sales in the last two months of 2003. Sales at clothing and discount stores were up from last year, as was traffic at many District malls. In some areas of the District, contacts estimate that consumer spending increased as much as 15 percent compared with the same months of 2002. A major discount retail chain is opening three new stores in March 2004 and will be hiring new employees. Similarly, many new car dealers reported strong sales at the end of 2003. Some contacts cited the continuation of incentives as one reason for strong sales. Many contacts reported that, because of the strong new car market, the used car market has not been as robust. Both retailers and auto dealers are cautiously optimistic about strong sales throughout 2004.

Real Estate and Construction

As 2003 came to an end, home sales continued to do well in the Eighth District. November year-to-date sales in the Memphis area were up by 9.2 percent compared with November 2002. November year-to-date home sales were up by 17.0 percent in northern Kentucky and in southern Indiana, as well. Residential construction was up in most of the District's metropolitan areas compared with November 2002. Construction was brisk in northeast Arkansas, with no slowdown in sight. October year-to-date permit levels increased by 2.0 percent in the greater St. Louis metropolitan area, and contacts reported that residential construction is steady in west Tennessee.

Commercial real estate markets remained slack in most of the District. In St. Louis, the industrial vacancy rate fell to 7.3 percent in the fourth quarter (from 7.5 percent in the third quarter); the office vacancy rate, however, increased by 1.7 percent to 17.2 percent. Louisville's third quarter office vacancy rate was 20.4 percent, a modest increase from 19.7 percent in the second quarter, while the industrial vacancy rate fell to 8.7 percent from 9.1 percent in the same time frame. The Memphis area's third quarter vacancy rates were 15.3 percent for the office market and 19.9 percent for the industrial market. Commercial construction seems to be improving throughout the District. Contacts in Danville, Kentucky, and northeast Arkansas reported that construction is strong, and contacts in west Tennessee reported plans for several new projects.

Banking and Finance

Total loans outstanding at a sample of small and mid-sized District banks were down 4.4 percent between early September and early December. This decrease stems primarily from

real estate loans, which declined by 6.3 percent over the same period. Commercial and industrial loans increased 4.4 percent over the same period. Loans to individuals and loans to commercial banks declined slightly by 1.7 percent and 0.3 percent, respectively. At the same time, total deposits at these banks showed a modest decrease of 0.4 percent.

Agriculture and Natural Resources

Although the impact of the mad cow disease on the District remains to be determined, District prices of beef cattle for slaughter rose from November to mid-December, except in Illinois. Meanwhile, commercial red meat production and cattle and calf slaughter decreased in November compared with November 2002. Coal production in Illinois, western Kentucky, and Mississippi declined slightly in December compared with the same month last year. December year-to-date production for the District was down 4.5 percent from 2002. Contacts anticipate that the price of natural gas will be higher in 2004 because of the depletion of last year's stock, which will affect nitrogen fertilizer prices when the planting season arrives.

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Ninth District--Minneapolis

From mid-November through December the overall Ninth District economy grew at a healthy pace. Residential real estate, manufacturing, consumer spending, mining and tourism were up, while commercial real estate was mixed and the energy and agricultural sectors decreased. Labor markets were stable. Wage and price increases were generally moderate; however, significant price increases were noted in heating costs and scrap metal, and significant decreases were noted in beef.

Construction and Real Estate

Commercial building was mixed. A commercial real estate firm report revealed that the amount of industrial space absorbed in the second half of 2003 exceeded the amount vacated by 1.1 million square feet in the Minneapolis-St. Paul area, the highest absorption rate during the past three years. While the vacancy rate for industrial space was large, absorption could top 2 million square feet in 2004, according to the report. Office vacancy rates remained over 20 percent, including sublease space, in the downtown areas of Minneapolis and St. Paul. A city official expects faster growth in commercial construction in Sioux Falls, S.D., during 2004 compared with 2003.

Homebuilding continued to expand at a strong pace. Housing units authorized increased 9 percent in district states for the three-month period ended in November, compared with a year earlier. In Rochester, Minn., a city report showed stronger homebuilding activity in November compared with last year. Home sales were down slightly in the Minneapolis-St. Paul area from a year earlier; nevertheless, year-to-date gains had already surpassed total sales in 2002. Relatively high vacancy rates for apartment rentals were reported in the Minneapolis-St. Paul area. In Billings, Mont., November home closings were 16 percent higher than last year.

Consumer Spending and Tourism

Retail sales during the holiday season were generally up from a year ago. A mall in North Dakota reported same-store sales up about 3 percent during the holiday season compared with a year ago. A Minneapolis area mall manager reported about a 1 percent gain in sales

overall, with some stores reporting no increase and others strong gains. Strong traffic from Canada boosted retail sales, according to a chamber of commerce representative in North Dakota. A Montana mall manager said sales were about even compared with a year ago. A major Minneapolis-based retailer reported same-store sales during the first four weeks of December were up from last year, but were running below its plan for a 4 percent to 6 percent increase.

Bank directors reported solid new and used car sales, particularly for large SUVs and pickup trucks. A South Dakota auto dealer association representative noted that recent vehicle sales were higher than last year.

Tourism activity was generally up from last year due to solid snowfall in several areas of the district. Downhill ski reservations in northwestern Montana were above a year ago. Early snowfall helped boost cross country skiing in northwestern Wisconsin, while a recent large snowfall in Montana and South Dakota has spurred a significant jump in skiing and snowmobiling compared with last year. A Minnesota ski resort reported strong visit numbers, about the same as last year. In contrast, a recent warming trend in Michigan's Upper Peninsula has drastically slowed winter activity; up to 80 percent of reservations in some areas were canceled during the holidays.

Manufacturing

Manufacturing activity increased. A December survey of purchasing managers by Creighton University (Omaha, Neb.) indicated overall improved manufacturing activity in the Dakotas and Minnesota. In addition, several manufacturers expect growth in sales and capital expenditures in 2004. A Minnesota capital equipment supplier noted that orders increased significantly over the last two months. An expansion at a milling plant in North Dakota was recently announced. A plastic product producer plans to expand in the Upper Peninsula. In Montana, an adhesive label company is building a manufacturing facility. However, a sawmill in Montana reduced production in December because of weather conditions.

Energy and Mining

Activity in the energy sector decreased slightly, while the mining sector increased. Mid-December district oil and natural gas exploration amounts decreased from early November levels. Most major district operating iron ore mines continue to produce at near capacity, and a previously shut mine reopened. The Great Lakes shipping season was extended for 10 days to accommodate additional taconite shipments. However, a mine in the Upper Peninsula temporarily shut down a kiln due to mechanical problems. In Montana, a molybdenum and copper mine reopened. Several mines reported strong prices for their products.

Agriculture

Agricultural economic conditions deteriorated. The cattle industry faced disruption as the U.S. Department of Agriculture discovered a cow infected with mad cow disease. Several countries closed their borders to importing U.S. beef and live animals. The price of cattle subsequently decreased. Due to the large crop harvest and shortages of storage space and rail cars, record amounts of grain were stored on the ground in North Dakota. Meanwhile, even with a late December storm, drought conditions continue to exist across most of the district.

Employment, Wages and Prices

November district employment was stable, although recent signs of growth were noted. Nonfarm employment was down almost 1 percent in district states in November compared with a year ago.

Hiring announcements included a telemarketing business based in Duluth, Minn., that plans to hire as many as 100 employees. Two airline reservation centers in Minnesota will boost employment by about 200 workers due to company consolidation from another state. In South Dakota a financial services company will soon add over 150 jobs, a teleservices company will employ 130 new workers, and a marketing company plans to create 100 new jobs over the next year. A temporary staffing agency survey showed that 24 percent of employers in Minneapolis-St. Paul expect to hire more workers during the first quarter of 2004 and 13 percent expect to reduce payrolls. Last year 20 percent expected to increase payrolls; 16 percent planned reductions.

In contrast, a plastics plant will soon shut down in southern Minnesota, affecting almost 100 employees. Previously announced plans to lay off about 700 workers at a South Dakota computer company are under way.

Wage increases were generally modest. For example, according to a recent contract agreement at a freezer plant in Minnesota, employee pay is frozen during the first year of the contract and increases slightly in each of the following two years; the employee share of health insurance premiums won't increase, but copayments will. State employees in South Dakota will not receive pay increases in 2004.

While price increases were generally modest, significant increases were noted for residential heating and scrap metal, while beef prices dropped. According to bank directors, overall price increases were modest. One director noted that commercial property insurance prices were leveling after a period of significant increases. Residential heating costs were up about 20 percent in November from last year, while scrap metal prices were up over 45 percent. Beef prices fell steadily following the discovery of mad cow disease in late December.

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Tenth District--Kansas City

The Tenth District economy strengthened further in December, and contacts were generally optimistic about future activity. Holiday retail sales were quite solid, labor markets firmed slightly, and manufacturing continued to expand. Winter tourism activity got off to a strong start, and the housing and energy markets remained strong. On the negative side, commercial real estate markets remained weak. The district farm economy remained strong, but contacts were somewhat uncertain about future conditions due to the appearance of mad cow disease. Wage and price increases generally remained modest, although some materials prices continued to rise rapidly.

Consumer Spending

Retailers were generally pleased with holiday retail sales. Most stores reported December sales were well ahead of a year ago, and many managers said it was their best Christmas season since 2000. A few discount stores, however, reported year-over-year gains were slightly less than they expected. Among product categories, sales of electronics were particularly strong, although managers generally reported solid sales of nearly all types of items. An exception was winter apparel, which suffered from unseasonably warm weather in

most areas of the district. Store managers were generally satisfied with inventory levels following the holidays and plan few adjustments heading forward. Most managers were optimistic that solid year-over-year sales growth would continue in coming months. Sales of motor vehicles generally held steady in December but were still below year-ago levels in some areas of the district. Looking ahead, most auto dealers expect sales to be stronger by the end of winter. Tourism activity in the district was strong over the holidays. Airport traffic continued to increase in most cities, and most Rocky Mountain ski areas reported an increase over last year's near-record holiday season.

Manufacturing

District manufacturing activity continued to expand in December, and expectations for future output remained high. Compared to the previous survey, most plants reported slightly higher levels of capacity utilization and modest increases in employees and hours. Consistent with the recent increases in activity, supplier delivery times lengthened slightly, and several manufacturers reported difficulties obtaining materials, particularly steel. Expectations for future production remained very high, as the volume of new orders continued to rise and a sizable backlog of orders emerged. More firms than in previous surveys also plan to increase capital spending in the months ahead, primarily to replace outdated equipment but also in some cases to expand capacity. On a negative note, some meat-packing plants in the district have laid off workers or warned of future cutbacks due to the impact of mad cow disease on their export business.

Real Estate and Construction

Residential real estate activity in the district remained quite solid in December, while commercial real estate activity was still weak. Single-family housing starts continued at a strong pace in most district cities. Construction of entry-level homes provided most of the strength but, for the second survey in a row, some builders also reported signs of a turnaround in high-end single-family construction. Most builders expect home construction to be steady through the rest of the winter. Builders reported few difficulties obtaining construction materials, in part because of weakness in commercial and multifamily building activity. Heading forward, a few builders were concerned about the availability of lumber, but they generally did not anticipate sizable problems in obtaining materials. Although still quite high by historical standards, home sales continued to ease from summer peaks in most district cities, and realtors generally expect sales to be flat through the winter. In an exception to the trend, home sales in Denver have finally begun to pick up, and Denver realtors expect activity to continue to rebound in coming months. Mortgage lenders reported further declines in mortgage demand, due largely to continued easing in refinancing activity but also to slower home sales. Most lenders believed refinancing activity had neared a bottom, and they expect total mortgage demand to be flat to slightly higher in the months ahead. Commercial real estate activity in the district remained weak in December, as office vacancy rates showed little or no improvement. Realtors generally expect little change in commercial real estate markets in the months ahead.

Banking

Bankers report that loans edged up and deposits remained unchanged since the last survey, boosting loan-deposit ratios slightly. Demand increased for consumer loans and home equity loans, making up for a decline in the demand for home mortgage loans. Demand for other loan categories remained unchanged. On the deposit side, liquid accounts, small time deposits, and large CDs all held steady. All respondent banks left their prime lending rates and consumer lending rates unchanged. No changes in lending standards were reported.

Energy

District energy activity remained strong in December, as energy prices rose further. The count of active oil and gas drilling rigs in the region was unchanged from the previous survey but still nearly 50 percent higher than a year ago. District energy contacts expect natural gas production to remain high in coming months but for oil production to decline slightly. Most district energy firms plan modest increases in capital spending in 2004, with an emphasis on natural gas.

Agriculture

The district farm economy remained strong in December, although the appearance of mad cow disease and continued drought in some areas caused concern about future conditions. Farm incomes continued to benefit from the high soybean and cattle prices that emerged in the fall. Despite higher incomes, however, farmers remained reluctant to expand their operations and make large investments. While soybean prices are generally expected to remain strong, uncertainty surrounding mad cow disease and plummeting cattle prices were causing some ranchers to take a wait-and-see approach before making additional investments in their cattle herds. In addition, the district's winter wheat crop remains dry and timely moisture will be needed for a good harvest.

Wages and Prices

Wage and price increases generally remained modest in December, although some materials prices continued to rise rapidly. Labor markets were still slack around the district. However, layoffs subsided considerably and more firms than in previous surveys reported problems finding and retaining workers. Among the workers reported to be in shorter supply were entry-level bank tellers and retail clerks, skilled technicians, and rig workers. Some builders also offered bonuses or new benefits in an effort to retain craftsmen. In addition, some contacts reported tentative signs of increased demand for tech workers, although such workers were still easily recruited. Most firms continued to offer only cost-of-living wage increases, while benefit costs continued to rise rapidly. As for prices, many retailers reported less pre-Christmas discounting than in previous years, and stores generally expect less post-holiday discounting as well. One retailer also anticipates raising prices slightly in coming months in order to match expected price increases by suppliers. Builders reported prices for construction materials remained well above year-ago levels in December, and prices are expected to ease little in coming months. Manufacturers reported a large rise in materials prices, especially for steel, and many expect price increases to continue in the near future. Contacts also expect an increase in freight costs due to recent legislation governing trucker hours. Manufacturers' finished goods prices continued to firm and managers increasingly expect to be able to pass some of their cost increases through to customers in the near future.

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Eleventh District--Dallas

Eleventh District economic activity expanded modestly from mid-November to early January. Contacts expressed optimism about the outlook for 2004 and are increasingly taking steps to increase capital spending and hiring as a result. Manufacturing activity continued to recover, while the demand for business services strengthened modestly. Retailers reported that holiday sales were good but not great. Conditions were mostly

unchanged for the energy industry and for real estate and construction firms. The beef industry has been disrupted by fears of "mad cow" disease, but there was little change in other agricultural conditions.

Prices

Energy prices are higher. Natural gas prices jumped over 40 percent in December. U.S. crude oil prices were up in response to OPEC production restraint, terror uncertainties, cold weather, higher tanker rates and very low crude inventories in the U.S. In December, crude inventories twice set records for the lowest levels ever seen during the month. OPEC has not responded to prices above their announced target range for a variety of reasons including a weaker dollar and expectations that supply will be stronger in the spring. Heating oil prices have been volatile but ended the period up slightly-responding to cold weather, a spike in natural gas prices, and higher crude prices. The price of regular gasoline was stable at \$1.48 to \$1.50 per gallon throughout the period, although December pump prices were the highest ever for a December. Gasoline demand has been running at rates above the five-year maximum all year, including November and December.

The spike in natural gas prices was a shock to large users like petrochemical producers. Domestic producers absorbed the additional costs, hurting profit margins. Prices for plastic resins remained stable in December. High natural gas prices have led to a moderate rise in the price of cement, sand, gravel and aluminum, and one respondent expressed concerns about being driven out of business by natural gas cost pressures.

Transportation firms reported concerns over rising fuel prices, although their ability to pass these cost pressures onto selling prices is mixed. Intense competition is keeping trucking prices unchanged, but strong demand is allowing some price increases for rail shipments. Airlines say selling prices continue to be soft.

Producers of primary and fabricated metals say input prices have skyrocketed. Shortages of steel, scrap and rebar were reported. Apparel prices continue to face downward pressure from tough global competition. Prices for most telecommunications and electronics products continue to decline. Retailers say that prices are declining at a slower rate. Auto dealers report that input prices and manufacturer incentives are unchanged, but selling prices continue to decline.

Labor Market

The labor market appears to be strengthening slowly with scattered reports of increased hiring. Still contacts report concerns about rising costs for health care and other employee benefits, including an increase in the Texas unemployment tax. Rising wage pressures are reported for some types of workers, such as skilled mechanics and clerical workers. Temporary service firms say wages and salaries have increased 3 percent to 4 percent in the past quarter, but individuals that were making about \$15 an hour in 2001 are currently making about \$13.50 an hour. Financial stress continues to exert downward pressure on wages and employment levels in the airline industry.

Manufacturing

Manufacturing activity was improved for most products, including food, metals, lumber and paper products. Apparel producers reported no change in sales growth over the past month and say tough global competition continues to put pressure on the industry. An exporter of manufactured equipment noted an increase in projects in the Middle East following the

capture of Saddam Hussein.

Demand for construction-related products, such as concrete, brick and glass, has been better than expected, which contacts attribute to favorable weather conditions. The outlook is "cautiously optimistic." Producers are cautious because of high natural gas prices and uncertainty about interest rates, but are optimistic because of productivity improvements achieved by modifying the mix of fuel content and the start of new public and commercial construction projects.

Respondents in high-tech manufacturing reported a continued moderate growth in orders with a slight acceleration in orders for latest-technology products and research. One respondent noted that the recent improvement in the economic outlook has motivated companies to increase their investment in cutting-edge technology so that they can stay ahead of the competition. Inventories were reported to be close to desired levels with retailers keeping lean inventories, and one manufacturer reporting that they were trying to build inventories. Contacts said they continue to outsource functions such as logistics and information technology to companies in the U.S. and overseas. Most contacts expect sales to grow at a 5 percent to 10 percent annual rate over the next three-to-six months.

Telecommunication manufacturing firms reported continued slow recovery, with demand up slightly and inventories declining slowly. The decrease in inventories and the growth of broadband use has helped to boost future prospects for the industry, although a robust recovery is not on the horizon. Domestic employment levels are not expected to increase, but plans to hire or outsource in the Asian Pacific region, particularly China, could boost worldwide employment.

Refiners raised production levels in response to cold weather and higher heating oil prices. Imports of refined products have been running at high rates, above the five-year maximum. Petrochemical markets continued to be plagued by overcapacity, despite rising demand from an improving U.S. economy. High natural gas prices have resulted in the loss of most export markets, further worsening the overcapacity situation. Producers are also facing growing competition from foreign producers for domestic markets.

Services

Legal firms reported robust growth in the fourth quarter. Litigation activity was still strong, and transactional/venture capital activity continued to strengthen. One contact noted a slowdown in bankruptcy work. Accounting activity was flat.

Temporary service firms reported only a slight increase in activity. Demand is strongest to supply health care workers, but orders grew considerably for IT and light industrial. Demand for workers to supply call centers and administrative/clerical positions have been weaker than expected.

Transportation firms, including trucking, airline and rail, reported increased demand. Rail shipments of grain have been boosted by good crop yields in the U.S. and higher demand from abroad. There has also been an increase in rail shipments of lumber and wood as a result of sustained growth in the housing construction market. The airline industry continues to improve modestly. Holiday demand was stronger in 2003 than in 2002, but demand was weaker than expected, which contacts attribute to the increased homeland security alert status.

Retail Sales

Retail sales started the holiday season slowly but ended it with a flourish. Overall contacts said that sales were good but not great. The industry remains very competitive, but contacts say there are fewer massive promotional efforts because consumers expect low prices and aren't attracted to the "loud noise of discount." Inventories are in good shape. Auto sales remain flat.

Construction and Real Estate

On the commercial side, office market fundamentals remained weak, but respondents are increasingly optimistic that the worst is behind them. Still, most contacts don't expect a major improvement in office markets until late 2004 or early 2005. Industrial real estate continues to perform relatively well, and most contacts in that industry are cautiously optimistic that demand will remain steady in the first quarter.

On the residential side, multifamily markets remain soft, with little change in demand. Apartment construction has subsided some, according to contacts, but there are still significant projects in the pipeline. While vacancy rates have flattened, there continues to be downward pressure on rents. Single-family builders say demand is flat to down, and fierce competition is keeping a lid on price increases. Contacts in the existing home market remain concerned about the amount of inventory available to buyers. Most single-family respondents were guarded in their outlooks, hoping for a pickup in job growth in 2004.

Energy

Crude oil demand has been at levels well above the five-year average since October, but there has been little change in energy activity. The domestic rig count remained near 1100 and drilling in the Gulf of Mexico is at a depressed 100 rigs. International drilling continues to improve. There continues to be excess capacity in the oil services and machinery industry, leading to sluggish pricing and moderate profits. In 2004, producers expect U.S. oil drilling to decline roughly 7 percent from current levels. International activity is expected to increase 6 percent.

Agriculture

Crop conditions were mostly unchanged, but the first U.S. case of "mad cow" disease led to a significant drop in cattle prices. Thirty-five international markets closed their borders to U.S. beef. Contacts consider U.S. beef safe but say cattlemen may delay liquidating herds, reducing beef production in 2004. Some contacts were hopeful that Mexico and Canada would soon re-open their borders to U.S. beef. However, most contacts were uncertain about how the American consumer would respond while the extent of the disease in the U.S. is being determined.

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Twelfth District--San Francisco

Summary

Reports from Twelfth District contacts indicate that the economy expanded soundly in late November and December, representing a slight improvement from the previous survey period. Consumer and producer prices generally were stable, although respondents noted increases in some energy and material costs. Wage and salary increases remained modest, with the growth rate of total compensation edging up. District retailers reported robust

holiday spending by consumers, with higher sales and less discounting relative to last year. Manufacturing activity in the District continued to expand, representing a pickup in the pace of growth in several sectors. District housing markets remained strong and commercial real estate markets showed further signs of improvement. With the exception of cattle ranchers--who were affected by the discovery of mad cow disease in Washington state--conditions among District agricultural producers remained solid. Reports from District banking contacts indicated that demand for commercial and industrial loans remained subdued, though demand for small-business loans improved slightly.

Prices and Wages

District contacts generally noted little change in prices in the recent survey period. Exceptions to this pattern were for natural gas, homebuilding materials, and certain manufacturing inputs such as steel plate. Contacts said that stiff competition among domestic businesses continued to constrain pricing power.

Despite a pickup in hiring, wage and salary pressures in the District remained modest in recent weeks. However, contacts noted that, as job markets have improved, companies have found it more difficult to shift increases in healthcare premiums, workers compensation insurance premiums, and other employee-related costs to workers. As a result, the growth rate of total employee compensation has edged up for many employers.

Retail Trade and Services

District contacts indicated that sales of retail merchandise were brisk in late November and December, with both dollar sales and unit sales up considerably relative to last year. In general, retail contacts reported limited holiday season discounting, especially for electronics, jewelry, and high-end apparel. Discounting was prevalent among low- to moderate-priced apparel sellers. Most contacts reported that holiday sales met expectations, leaving retail inventories in balance heading into 2004. Automobile dealers reported some improvement in sales in December, boosted by renewed financing incentives and year-end discounts on remaining 2003 models. In California, the reversal of the October increase in the vehicle license fee reportedly contributed to a pickup in sales; this allowed most District auto-dealers to run down inventories that were accumulated in October and November.

Business conditions for District service providers continued to improve, with several noting firmer demand. Advertising and marketing firms reported a rise in contracts for print and radio advertising campaigns. Demand also strengthened for accounting and legal firms, stimulated by interest in corporate pension planning and tax preparation services. Contacts at West Coast ports indicated that improved export traffic and holiday season importing kept several District seaports operating at capacity in December. Demand for preventative and outpatient healthcare services continued to grow in the District. Conditions in the District travel and tourism sector remained strong; several contacts noted a surge in travel associated with unusually good conditions in prominent ski areas.

Manufacturing

District manufacturing activity increased further in late November and December, with the pace of growth accelerating in many sectors. Makers of machine tools, building materials, furniture, and construction equipment noted that growth of sales and orders for their goods accelerated in recent weeks. One District machine tool maker said that the recent demand surge nearly filled company order books for 2004. Orders for and sales of semiconductors and other high-tech products continued to grow, boosting capacity utilization at several

plants. A weaker dollar helped District apparel makers expand output, but most continued to operate below full capacity. Improved demand for manufactured goods reportedly surprised some raw material and equipment suppliers; several manufacturers noted that they were having difficulty obtaining inputs in a timely fashion. Although most manufacturers in the District remained cautious about expanding payrolls, a few contacts noted that they have begun to hire highly-skilled workers.

Agriculture and Resource-related Industries

With the exception of cattle ranchers--who were affected by the discovery of mad cow disease in Washington state--conditions among District agricultural producers remained solid. Contacts reported strong seasonal sales of cut flowers and Christmas trees over the holiday season. Prices for most other agricultural goods reportedly were stable and inventories generally remained in balance. Export bans on beef and beef products associated with the discovery of a case of mad cow left several traditional cattle ranchers and feed lots in the District with excess inventories. The mad cow scare has benefited some organic beef ranchers; sales of range-raised beef reportedly rose considerably in recent weeks.

Real Estate and Construction

District residential real estate markets remained robust during the most recent survey period. Sales of new and existing homes increased throughout the District and home-price appreciation remained solid. Conditions on the commercial side improved slightly, with office vacancies and lease rates stabilizing in most markets. Several commercial landlords noted that businesses have begun to take advantage of the low-lease rate environment to obtain more desirable locations or more desirable office space. In San Francisco, for example, businesses have begun to move from surrounding suburbs to the city of San Francisco. Contacts in other areas of the District report tenants moving from Class B to Class A office buildings.

Financial Institutions

District banking contacts indicated that commercial and industrial lending remained subdued in late November and December. However, demand for small-business loans reportedly improved slightly in some areas, and contacts noted increased inquiries about rates and loan terms. Mortgage lending remained healthy but down from the prior survey period and from the same period a year ago.

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