



September 8, 2004

Summary of Commentary on Current Economic Conditions by Federal Reserve District

Summary

Prepared at the Federal Reserve Bank of San Francisco based on information collected before September 1, 2004. This document summarizes comments received from businesses and other contacts outside the Federal Reserve System and is not a representation of the views of Federal Reserve officials.

Reports from the Federal Reserve Banks indicated that economic activity continued to expand in late July and August, although several districts indicated that the pace had slowed since their last reports. Districts' characterizations of the rate of expansion ranged from slow (St. Louis) to solid (San Francisco), with many districts reporting modest or moderate growth.

Household spending was reported to have softened in many parts of the nation, reflecting lackluster retail sales and some cooling in new and existing home sales. Conditions in the manufacturing sector, on the other hand, improved further nationwide, especially among capital equipment and other durable goods makers. Residential construction activity remained at high levels but slowed a bit in some regions; nonresidential construction remained tepid, as did demand for commercial and industrial space. Agricultural conditions were mixed and generally tied to the weather. Demand for consumer loans softened somewhat, but several districts noted increased commercial lending. Employers in most districts continued to expand payrolls, though districts reported some unevenness across sectors. While persistently rapid increases in nonwage labor costs continued to be a concern for many employers, wage pressures remained modest. Consumer prices were generally flat or up modestly, although there were noticeable price increases for energy and some material inputs.

Consumer Spending

Consumer spending was mixed across districts and across products in late July and August, with the pace of spending slowing on balance relative to the previous survey period. Retail sales were described as solid in San Francisco, mixed in Dallas, and softer in New York, Richmond, and Chicago. Despite the recent slowing in retail sales, several Reserve Banks noted that sales were still up on a year-over-year basis. By category, a few districts singled out computers and other electronics and women's accessories and jewelry as being in particularly strong demand. Sales of back-to-school items, especially children's apparel, reportedly were disappointing for retailers in New York, Cleveland, Richmond, Chicago, and

St. Louis. By contrast, Kansas City indicated that sales of these items were up solidly from previous years, and Philadelphia noted that they were in line with merchants' expectations.

With respect to autos, sluggish sales, high inventories, or both were noted by contacts in Cleveland, Richmond, Atlanta, Chicago, and Dallas. St. Louis, San Francisco, and Kansas City, on the other hand, reported improvement in motor vehicle sales. In terms of composition, Kansas City and Dallas indicated that SUVs and light trucks did not sell as well as smaller vehicles, though the opposite was true in Atlanta and Chicago.

Business conditions in the travel and tourism sector were reported to be strong on balance in the districts of San Francisco, Kansas City, Atlanta, and New York, and in some areas of the Minneapolis and Boston Districts. Rainy weather in the Northeast and unusually cool weather in northern Minnesota damped travel to those areas. Hurricane Charley and Tropical Storm Gaston deterred travel and tourism to some coastal areas in the Richmond District. The Atlanta District noted that most central Florida tourist attractions closed for only one day because of the hurricane, and damage to the theme parks was limited.

Manufacturing and Other Business Activity

Total manufacturing activity increased throughout the country. Districts noted that manufacturers of durable goods, including many types of capital equipment, showed the largest increases. Specifically, strong demand was reported for aerospace products (Boston, Atlanta, and San Francisco), steel products (St. Louis), industrial machinery (Richmond and Chicago), and IT products (Chicago, Dallas, and San Francisco). In addition, Philadelphia noted increased demand for instruments and electrical equipment. The few indications of weakness in selected manufacturing sectors came from the St. Louis District, which reported that firms in home fixtures, furniture, and electronic cable manufacturing anticipate plant closings, and the Cleveland District, where nondurables manufacturers noted high inventories of finished-goods and flat to falling capacity utilization. Reduced demand for transportation equipment in the Philadelphia District and for apparel in the Richmond and Atlanta Districts also was reported.

The generally robust activity in manufacturing boosted demand for transportation services in many districts. Cleveland, Chicago, St. Louis, and Kansas City reported strong demand for overland shipping services, which resulted in bottlenecks in freight movement in some areas. According to the San Francisco District, high volumes of international trade kept several West Coast seaports operating at capacity, which also led to increased demand for rail services. Similarly, New York noted that volume through the Port of New York and New Jersey rose substantially in July and August.

Regarding other services, activity during the survey period was mixed. St. Louis and San Francisco noted improvement in demand for health-care services; San Francisco also reported improved demand for the services of advertising and media firms. In contrast, in the Richmond District, service firms reported generally weaker customer demand, and the New York District cited a contact who reported weakened demand in the securities industry. Boston noted deceleration in demand for software and IT services in late July and August, despite increased demand for IT hardware.

Real Estate and Construction

Home price appreciation, home sales, and residential construction activity remained at high

levels in most districts, although there were numerous reports of slight cooling in market activity. Signs of moderation in the pace of home price appreciation and/or sales were reported by New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, Kansas City, and San Francisco. The Dallas report described housing markets in Texas as "lively," but noted little increase in median home prices this year.

Commercial real estate markets were little changed from the last survey period. Most districts reported stable but high vacancies and steady but low rents. That said, there were, scattered reports of improvement. The New York District reported that the office market in Manhattan strengthened further in July and the Richmond District noted commercial leasing activity increased in the Washington, D.C., area. Also, the St. Louis District indicated slow improvement in commercial and industrial real estate markets.

Agriculture and Natural Resources

Agricultural output and conditions in late July and August varied across the nation, with weather, as usual, playing the key role. Cooler-than-normal weather in many parts of the country, most notably the agricultural regions of the St. Louis, Chicago, Kansas City, and Minneapolis Districts, slowed crop development. The Dallas, Atlanta, and Richmond Districts noted that excessive rainfall hampered crop development. The Atlanta and Richmond Districts bore the brunt of Hurricane Charley, though its damage to crops reportedly was limited to coastal areas. Atlanta reported that the USDA estimated that Hurricane Charley ruined around 20 percent of this year's citrus harvest, including about 10 percent of the orange crop.

Higher energy prices continued to encourage oil and gas extraction. Kansas City reported that the count of active oil and gas drilling rigs in the region increased slightly from the previous survey period and was up strongly from a year ago. Oil drilling activity also was reported to have increased in the Dallas District.

Financial Services and Credit

Loan demand improved on net in many districts in recent weeks, as an uptick in demand for commercial loans offset some softening in consumer loan demand. Credit quality for both loan types was steady to slightly improved. Reports indicate that demand for commercial and industrial loans increased in the New York, Richmond, Atlanta, St. Louis, and San Francisco Districts. Commercial lending was flat in Philadelphia, Chicago, Kansas City, and Dallas. Respondents in two of the districts where commercial lending was flat--Chicago and Kansas City--indicated that loan demand from businesses was restrained to some extent by the use of internal financing, as the cash flow of many businesses improved.

On the consumer side, loan demand moderated somewhat in several districts, largely due to a falloff in mortgage lending. Some districts reported continued moderate increases in consumer loans, but several noted softening demand for home purchase and refinance loans. In characterizing home loan demand, the Chicago and Kansas City Districts indicated slight increases, and Richmond reported moderate increases. Cleveland, New York, Dallas, and San Francisco all noted softening in demand for home loans, while Philadelphia described demand for such loans as mixed.

Labor Markets, Wages, and Prices

Reports from most districts suggest continued gains in jobs during the recent survey period, although with some unevenness across sectors and regions. Several districts noted a pickup in demand for temporary service workers, including those in manufacturing, and one district (Atlanta) reported an increase in the rate of conversion of temporary workers to permanent hires. District reports also mentioned increased hiring in the energy, transportation services, durable goods manufacturing, and health-care sectors. The Cleveland and San Francisco Districts reported a pickup in labor demand among banks. Hiring reportedly was more subdued among producers of nondurable goods and selected services firms. In some cases, job losses were recorded: apparel manufacturers continued to shed jobs in the Atlanta District, and some financial and educational services providers scaled back employment in the St. Louis District.

Wage increases remained modest overall, although there were reports of upward wage pressures for selected occupations and industries. Reports indicated that wage pressures were building for skilled workers, and remaining flat for other types of workers. District reports continued to note concerns among businesses about the rising cost of health care and other employee benefits.

The reports indicated that consumer prices were generally flat or up modestly in late July and August, although they continued to cite noticeable price increases for oil, natural gas, steel, lumber, cement, concrete, and other building materials. This characterization of price developments was widespread across the districts. In addition, Cleveland and Dallas noted price increases for processed foods, and Chicago indicated that higher oil prices have driven up the cost of plastics, rubber, and other petroleum-based materials. Despite the high oil prices, however, two districts (Minneapolis and Dallas) reported that gasoline prices had increased only moderately if at all. In this regard, refiners in the Dallas District reported that the steep rise in crude oil prices relative to gasoline has squeezed margins.

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First District--Boston

First District businesses contacted near the end of August generally report economic activity is increasing. Most contacted retailers and two-thirds of responding manufacturers say sales during the summer months were up from a year earlier. Temporary employment firms cite healthy increases in demand. By contrast, some firms selling software and information technology services indicate that the pace of growth has been slowing. And commercial real estate markets, while no longer deteriorating, have yet to show improvement. Except for commercial real estate, contacted sectors' expectations for the coming 12 months center on moderate growth.

Retail and Tourism

Most contacted retailers in New England report improvements in July and August, as year-over-year sales range from flat to 25 percent gains. Products that sold particularly well this period include new office technology, women's accessories, paint, and lumber.

Inventory levels are generally in line with plans, with about half of the contacted retailers maintaining levels higher than the previous year. Vendor prices and selling prices are mostly stable, although several respondents report price increases for European goods and on some

commodity goods, like paper and lumber. Employment is generally steady, with some areas of growth, and wages are even. Contacts note some limited increases in capital spending, mostly on technology and new stores.

Travel and tourism revenues are said to be stronger in July and August compared to a year ago, although some pockets of weakness remain. Domestic travel increased moderately, while international travel climbed 40 percent compared to last year. Revenues in the Boston area rose, as anticipated, during the week of the Democratic National Convention; however, expectations were not met during the weeks before and after the convention. Rainy weather has had a negative impact on business in some areas, particularly Cape Cod and the coast of Maine, though summer tourism revenues in Newport, RI were reportedly 12 percent higher than last year. Some large resorts note employee shortages because many foreign workers were unable to obtain visas for seasonal employment, a result of homeland security restrictions.

Overall, retail respondents are upbeat about the remainder of 2004. While expectations of growth in the next four months range from flat to double-digit increases, many contacts express concern about the consequences of the November election and rising gas prices.

Manufacturing and Related Services

Two-thirds of First District contacts in manufacturing and related services report that sales were above year-ago levels by from 4 percent to 60 percent in the second quarter and early part of the third quarter. For the remaining one-third, sales were flat to down by as much as 10 percent. Demand from the defense sector, the commercial aircraft industry (for parts and services), and the semiconductor industry is notably robust. By contrast, firms serving the auto makers and selling construction-related products and household durables say demand in those sectors is soft. Almost half of the respondents describe business as better than expected or above plan, but several note new weak spots in recent weeks.

Over half of the contacted firms mention rising prices for energy, petrochemicals, and some metals and report that they have been, at best, only partly successful in passing these increases on to customers. Just one-third of respondents have raised their selling prices from year-ago levels, with the increases spanning 2 percent to 5 percent. However, most indicate that selling prices are flat to down year-over-year, reflecting "brutal" price competition in some consumer goods industries and "expectations" of ongoing price declines in electronics.

At half of the responding companies, third-quarter employment is flat to down year-over-year, with two firms planning further reductions. The other half report increasing their headcount from year-ago levels--from "selectively" to as much as 12 percent. A minority anticipate additional hiring, with two reporting difficulty finding engineers. Wage gains range from 2 percent to 4 percent, and up to 5 percent in a few cases. Rising health insurance costs remain a general cause for concern.

Just over half of the contacted manufacturers report they are increasing capital spending above plan or recent experience--generally just modestly. As one noted, it is hard to spend a lot on equipment if it is largely electronics. This spending reflects the need to improve efficiency, introduce new products, or relocate parts of the business. Only one firm is adding capacity.

Most manufacturing respondents report feeling upbeat--in several cases, more upbeat than in

many months. These firms generally expect further gains in 2005 in the context of continued moderate growth in the U.S. economy.

Temporary Employment

Demand for temporary employees across New England continued to grow at a healthy pace in Q2 and the beginning of Q3. Growth is strongest in technical, information technology, manufacturing, and light industrial employment; demand for financial and business services workers is also strong, while medical employment demand seems to have slowed somewhat. Permanent and temporary-to-permanent hiring continues to increase.

Downward pressure on bill rates has abated and contacts report some success in raising prices. Pay rates have grown only slightly, amid the decreasing but still ample supply of applicants. Most respondents express concern about high insurance costs, especially unemployment insurance.

Respondents at temp firms are content with the current rate of growth, which they expect to continue throughout the remainder of the year. While they are optimistic, contacts are concerned about the threat of terrorism, high oil prices, and election uncertainty.

Commercial Real Estate

Commercial real estate markets in New England have not improved during the summer months. Contacts report moderate activity levels, but lack of demand for new space. Office vacancy rates remain in the mid-teens in Boston, and exceed 20 percent in the suburbs. There has been negative absorption of office space in recent months. Following recent mergers, contacts expect about 1 million square feet of office space to be vacated in the Boston market later this year. While rental rates have not changed during the past three months, potential tenants can make "terrific deals," especially if they are willing to lease space in lower buildings, where vacancy rates are much higher than in high-rise office buildings. At the same time, buyers continue to pay "incredibly high" prices for commercial building purchases.

Markets in the rest of New England perform similarly. Contacts describe the markets as "slow but steady." Office vacancy rates are either constant or somewhat higher than at the beginning of the summer, while rental rates are flat to slightly softer. There has been little market absorption. Retail is the only strong segment of the market in most areas. Contacts do not expect any improvement in the remainder of 2004.

Software and Information Technology Services

Business activity in software and IT services is said to be slowing down. Contacts' year-over-year revenue growth in their most recent reporting period (mostly second quarter) ranges from somewhat negative to positive double digits. Excluding growth by acquisitions and the impact of currency, however, most contacts say their sales have been stagnant compared to the year-earlier level. Foreign demand is reportedly much stronger than domestic, which most exporting respondents attribute to the weak dollar. In general, contacts report that their clients' IT investments are restrained; some are choosing to put off big projects and implement smaller ones. Competition from new entrants and staffing firms persists in low-end segments.

As of late August, headcounts remain flat at most software and IT firms; they say they are reluctant to expand their workforces except for seasonal workers. Pay raises are generally keeping up with inflation. Increasing health care costs continue to be a big concern for most companies. Capital spending and technology development are running "as usual."

A new tone of caution has emerged regarding the short-term outlook for software and IT markets. In spite of strong orders in the pipeline, companies generally expect revenues to grow only gradually. The war and the federal budget deficit remain the top two issues affecting their assessments of the future.

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Second District--New York

The Second District's economy has shown some signs of slower growth in recent weeks. Retailers mostly report that sales softened further in August and were below plan, while selling prices were up modestly. The housing market has shown further signs of leveling off, though prices remain well above year-ago levels. The resale market has shown signs of moderating, while the rental market has continued to firm gradually. New York City's office market strengthened again in July, and a leading employment agency reports that the city's labor market has been stable and relatively firm since the last report. Tourism activity moderated somewhat in August, though the upcoming Republican convention is seen boosting activity for the week leading up to Labor Day. Finally, bankers report some slowing in household loan demand but a further pickup in the commercial segment; both credit standards and delinquency rates are reported to be little changed.

Consumer Spending

Retail sales were mostly below plan in August, after a mixed July, as almost all chains report weak demand for back-to-school merchandise. One contact did note that sales have been relatively strong and ahead of plan. Weather was not considered to be a factor in the soft results. One retailer attributes the recent softness to a somewhat later start to the school year. A few contacts note that, while traffic has been weak, higher-priced merchandise is selling relatively well. Some contacts report particular weak sales of goods for the home. More generally, inventories were still generally described as relatively lean. Selling prices are reported to be up modestly, mainly reflecting low stocks of summer clearance merchandise and, thus, fewer markdowns.

Consumer confidence rose in July, according to two separate surveys. Based on Siena College's survey of New York State residents, confidence rose sharply, led by a strong rebound in the New York City area. At the same time, the Conference Board's survey of Middle Atlantic state (NY, NJ, PA) residents shows confidence rising for the second consecutive month, reaching a roughly two-year high in July.

Construction and Real Estate

Housing markets, though still generally firm, have shown some scattered signs of moderating in recent weeks. New Jersey homebuilders report that the market for new homes remains tight and prices remain buoyant, reflecting escalating land costs. One contact expresses concern about affordability, noting that a growing proportion of buyers are opting for

adjustable-rate mortgages. Lumber prices, though substantially higher than a year ago, have leveled off in recent months, but concrete prices have continued to rise.

New Jersey Realtors report that home prices were up more than 10 percent in the second quarter, compared with a year earlier, and the number of homes sold rose more than 20 percent. Similarly, home prices across New York State continued to run more than 10 percent ahead of a year ago in July, while unit sales were relatively strong. More recently, however, one real estate contact notes some cooling in the resale market, reflected in a growing gap between asking and offering prices and a rising number of homes on the market. Manhattan's rental market has continued to improve, particularly at the high end, and rents on new leases, though still down roughly 5 percent over the past year, have continued to rise in recent months.

Manhattan's office market strengthened further in July. Downtown's rate fell another 0.5 point to 12.4 percent--the lowest level in more than two years--while Midtown's rate fell 0.3 point to 11.1 percent. Notably, the total volume of space available for sub-lease is reported to have reached its lowest level since October 2001. Overall, average asking rents were little changed in July.

Other Business Activity

A major New York City employment agency reports that labor demand appears to have held steady at favorable levels in August, with Wall Street continuing to hire. However, a contact in the securities industry contact notes that overall revenue growth has weakened recently, and expects the industry to reduce employment over the next year.

A contact in the shipping industry reports that, after a sluggish second quarter, volume through the Port of New York and New Jersey rose substantially in July and August, and has pulled well ahead of year-ago levels. This recent strong volume partly reflects a diversion of shipments from West Coast ports and is expected to continue for at least the next few months.

Tourism-related industries were mixed but generally operating at high levels in August. Manhattan hotels showed some signs of slowing in August, compared with June and July, when occupancy rates approached 90 percent. However, an industry contact notes strong bookings for the week before Labor Day, which is attributed to the Republican convention. Average room rates have continued to run roughly 10 percent ahead of a year ago. Broadway theaters also report some pullback in business in August, though comparisons to last year are complicated by the 2003 blackout.

Financial Developments

Small- to medium-sized banks in the Second District report mixed demand for loans since the last report. On commercial and industrial loans, more than twice as many bankers report increases as decreases. Demand for commercial mortgages held steady, while lower demand was reported for consumer loans and especially residential mortgages. Half of all surveyed bankers reported a decrease in refinancing activity, with just 6 percent reporting an increase.

Loan rates increased across all categories, particularly on commercial credit and residential mortgages. Most bankers also report further increases in deposit rates. Credit standards remained the same, with almost all respondents reporting no change across all loan segments.

Bankers reported unchanged delinquency rates across all loan categories except residential mortgages, where further improvement was noted.

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Third District--Philadelphia

Business conditions in the Third District improved modestly in August. Manufacturers reported moderate increases in orders and shipments during the month. Retailers indicated that sales of general merchandise rose in August compared with July and with August of last year, although the year-over-year gain was slight. Banks and other lending institutions reported that overall lending continued on an upward trend, although some noted that mortgage activity has eased. Sales of existing homes have been steady, but sales of new homes have slowed somewhat. There have been some indications that demand for office and industrial space might be turning up in some parts of the region, but overall the commercial real estate market remains soft.

Contacts in the Third District business community generally expect economic activity in the region to expand through the fall and winter, but most do not expect strong growth. Manufacturers anticipate increases in shipments and orders during the next six months. Retailers expect sales for the fall to be better than sales in the same period last year, but they do not believe the growth rate of sales will accelerate significantly from the current pace. Bankers expect overall lending to increase, primarily as a result of gains in consumer lending. Real estate agents and home builders expect home sales to remain strong, although they think the sales rate going forward could be slower than what it has been for the year so far. Contacts in commercial real estate anticipate a slight increase in demand for space during the rest of this year.

Manufacturing

Manufacturing activity in the Third District increased moderately in August. Almost four in 10 of the manufacturing firms surveyed during the month posted higher shipments and orders compared with the prior month, and fewer than two in 10 reported decreases. Order backlogs at area plants were steady from July to August, but delivery times edged down. Firms in almost all of the major manufacturing sectors in the region indicated that business was growing. Increases in demand were especially strong for firms producing plastic products, electrical equipment, measuring and controlling instruments, and food products. However, makers of lumber and wood products reported generally steady orders during August, in contrast to increases in previous months, and producers of transportation equipment noted a falloff in orders.

The region's manufacturers generally expect further gains in business activity. More than half of the firms surveyed in August expect their shipments and orders to increase during the next six months, around one-third expect them to be steady, and less than one in 10 expect decreases. On balance, area manufacturing firms are scheduling increases in capital spending, and they are planning to add employees. The outlook is positive in almost all of the major manufacturing sectors in the region, but makers of wood products and electrical equipment expect a slowdown in business during the next six months.

Retail

Retail sales of general merchandise in the region rose in August compared with July and with August of last year. Although most of the retailers contacted for this report said their year-over-year gains were slight, several stores selling luxury goods and higher-priced apparel indicated their sales were well above last year's results. Back-to-school merchandise and fall clothing were generally selling about in line with merchants' expectations. Most retailers indicated that their inventories were at planned levels, but some stores reported that they still had summer merchandise to be sold.

Third District retailers expect sales for the fall to be above the same period last year, but they do not expect large gains. Several retailers said there was unlikely to be a strong pickup in overall sales in the absence of new products to stimulate consumer demand. A number of store executives said their expectation of slow sales growth was prompting them to delay expansion plans, although renovations of existing stores were proceeding on schedule.

Finance

Outstanding loan volume at Third District banks rose in August, according to banks contacted for this report. In the past several weeks, consumer credit has increased moderately. Commercial and industrial loans have been growing, although the gains have varied among banks. Some reported strong growth, but others have had only slight increases. Banks gave mixed reports on residential real estate lending. Some have had increases, but others indicated that mortgage activity has eased. In general, bankers reported steady to improving credit quality.

Bankers in the District generally expect overall lending to rise during the rest of the year. They anticipate continuing growth in consumer lending, but they have mixed views on business lending. Some bankers noted recent slowdowns in business loan applications, which they attribute to customers delaying expansion plans, but other bankers believe the slowdown may be merely seasonal. Residential real estate lenders expect mortgage activity to remain near the current pace as long as there is no appreciable increase in interest rates.

Real Estate and Construction

Commercial real estate firms in the Third District reported that office leasing activity has been growing slightly, although the increase in rented space has been small. Demand for space has edged up in some suburban markets but not in the Philadelphia central business district. On balance, there has been little change in the region's overall office vacancy rate, and effective rents remain under downward pressure. Commercial real estate firms expect demand for space to move up somewhat in suburban markets as long as regional economic conditions improve, but they expect continuing softness in the Philadelphia central business district. Industrial building vacancy rates have increased and rents have eased in most parts of the region. However, some areas of strong demand have emerged recently, and commercial real estate firms expect a more widespread increase in demand for industrial space in the months ahead.

Residential real estate agents indicated that sales have been roughly steady in recent weeks and above the pace during the same time last year. Although they reported that the supply of homes for sale is still tight, they noted some signs that price appreciation appeared to be easing. Home builders reported a slowing in sales in August. Some builders said the slowing was primarily seasonal and they expect sales to pick up by the end of September. Builders

reported that they have been raising prices in response to rising material costs and that the price increases have had little negative effect on sales. Both builders and real estate agents expect the pace of sales to remain strong unless mortgage interest rates move up significantly.

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Fourth District--Cleveland

Reports on economic activity from across the Fourth District were mixed in the eight weeks ending in mid-August. Activity continued to slow in some sectors, while others saw sales and production rebound in recent weeks. For most District manufacturers, production remained well above year-ago levels; however, increases in activity in recent weeks were largely confined to durable goods producers. In the retail sector, sales continued to be weak for most firms. Residential construction also continued to slow somewhat in recent weeks, and nonresidential builders continued to confront weak demand. By contrast, District banks reported steady loan demand from commercial and consumer clients alike, although mortgage refinancings remain weak. The transportation sector continued to report robust rates of activity.

As has been the case for many months, elevated input costs continued to confront firms for items such as steel, food, and petroleum products. Plans to add equipment and employees are still not broad based; however, companies that provide staffing services reported an increase in openings and placements in the last several weeks.

Manufacturing

Most durable goods manufacturers reported increases in production in the eight weeks ending in mid-August. On a year-over-year basis, activity remains much improved for most manufacturers. Steel producers continued to see strong shipment volumes, with some firms indicating that the usual summer slowdown in shipments was not as pronounced this year. However, some steel-industry contacts expect demand growth to slacken in the months ahead. District auto production appeared to be down on a year-over-year basis. For nondurable goods producers, production levels were typically reported to be flat for the last few weeks, although above year-ago levels.

While most durable goods manufacturers characterized their inventory levels as acceptable, several nondurable goods manufacturers indicated that their inventory levels were higher than desired. Moreover, while durable goods manufacturers indicated increases in utilization rates, nondurable goods manufacturers noted that their utilization rates were flat or falling slightly. Finally, most durable goods manufacturers expect to add to payrolls and to their capital stock in the next few months; however, nondurable goods manufacturers remained less likely to report plans to expand levels of employment or equipment.

Input costs continued to be a concern for most manufacturers. Prices paid by District manufacturers for petroleum-based products and for steel and other metals reportedly rose further in recent weeks. Food processing firms also again reported increases in the prices for some foods, including milk, chicken, and beef. Durable goods producers reported raising prices to largely offset increases in input costs; however, nondurable goods producers were less able to pass input cost increases along to their consumers.

Retail Sales

District retailers reported weaker spending in July and early August. For most firms, sales in the late spring and throughout the summer have not met expectations. In particular, the back-to-school selling season, which many firms had hoped would revive weak sales, has been disappointing. Firms cited general concerns about the economic environment--including increasing gasoline prices and lackluster labor markets--as a possible reason for recent weakness. However, most contacts also noted that the causes of weakness were far from clear.

Firms reported fewer markdowns, in part from more strictly managed inventories. Compensation costs continued to be a concern for many firms, especially with respect to health care costs. For food-service firms and grocers, higher prices for food products were also reported again. In general, however, other input price pressures remain muted.

New car sales were generally weaker across the District in the eight weeks ending in mid-August. Some contacts cited seasonal factors for the slowdown. After attempts to reduce incentives earlier in the year, incentives are again at high levels. Finally, contacts indicated that inventories are at about a 90-day supply.

Construction

In July and early August, the pace of home sales slowed further for District homebuilders. Sales during this period were also below those of the same period a year ago. Unlike in the previous report, the slowing sales pace was reflected across various price points. Some builders suggested that the recent weakness reflected weaker economic conditions in the Midwest and reported stronger home sales for their firms elsewhere in the country. Changes in the cost of materials in recent months were mostly flat, though they remain significantly higher than they were last year. Labor and subcontractor costs were largely unchanged. Overall, builders now expect that total sales in 2004 will be below or equal to those in 2003; however, most builders have not changed their expansion or land-purchase plans.

Most nonresidential building contacts reported a recent slowing in inquiries and activity across nearly all building categories, continuing the pattern of recent months. Whatever improvement was reported appeared to be among smaller-scale projects, which were often industrial in nature. Year-over-year comparisons were more mixed. Contacts generally reported that their materials costs increased in the last six weeks, though less rapidly than earlier this year. Labor and subcontractor costs were generally unchanged, as were the prices charged by commercial contractors. Most firms do not anticipate much change in the economic environment in the months ahead.

Banking

Most banks characterized consumer loan demand as steady to slightly increasing for the eight weeks ending in mid-August, despite declining levels of mortgage refinancings. Several smaller banks also reported increases in loan demand from their commercial clients. Changes in core deposits were mixed across institutions, with several smaller institutions reporting flat or falling deposit inflows. Larger banks, however, have been able to increase their deposit inflows in recent weeks. Delinquencies reportedly remain at low levels. While smaller banks plan to keep staffing levels steady, many larger institutions reported plans to add additional

personnel in the months ahead.

Trucking and Shipping

Activity in the trucking and shipping services sector continued to be strong in July and early August. Demand continued to come from an array of industries. Strong shipping demand has led to bottlenecks on overland distribution channels, such as roads and railroads, and an increasing use of port facilities. Trucking firms reported having attempted to add to their staffs, but continued to confront high turnover rates. Most also plan to purchase trucks to expand their fleets soon. While fuel prices reached historical highs in recent weeks, contacts reported that they could pass these increases through to their customers using surcharges.

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Fifth District--Richmond

The Fifth District economy expanded more modestly in late July and August as retail sales and service sector activity weakened. Retail sales declined somewhat, automobile sales were sluggish, and shopper traffic tapered off in August. Services firms also reported weaker customer demand in August. In contrast, manufacturing continued to exhibit solid growth in recent weeks, with factory shipments and new orders picking up since our last report. Housing market activity remained at a generally high level, but homebuilding and sales activity slowed from the frenetic pace of last spring. In the District's labor markets, employment growth was modest in July and contacts told us that fewer employees were added to payrolls in August. While prices for manufacturing and construction materials moved moderately higher, overall price inflation in the District remained low. In agriculture, strong winds and heavy rain from Hurricane Charley and Tropical Storm Gaston damaged crops in some coastal areas. Despite the damage though, crop development was ahead of schedule across most of the District.

Services

Services firms reported generally weaker customer demand in recent weeks. A central West Virginia caterer said she was not seeing the usual number of advance bookings and she passed along the comments of her food supplier who was also seeing slower business. In South Carolina, a utility contact said that unusually mild summer weather had lowered electric consumption in that area. Trucking firms in Maryland and North Carolina reported little change in revenue growth in recent weeks. In contrast, a contact at an executive search firm in Washington, D.C., said demand for upper level executives was firming, particularly from associations and nonprofit organizations.

Retail

District retailers reported somewhat softer sales during the last six weeks. Automobile dealers said sales were flat to lower and that customer traffic in showrooms was light. A contact at an apparel store in Charleston, W.V., told us his back-to-school price discounts failed to move much merchandise. A department store manager in central North Carolina said that while his store was still "riding the back-to-school wave," he expected a lull once school started. Retail contacts indicated that employment edged lower in July and August and said that prices in the sector were rising at a moderate pace.

Manufacturing

District manufacturing activity grew solidly since our last report. New orders expanded at a brisk clip throughout July and August. Manufacturing employment and the average workweek expanded in July, but slipped somewhat in August. Producers of electrical equipment, fabricated metal products, and industrial machinery generally reported higher output in recent weeks. An electrical manufacturer in Maryland told us that they had received new orders from a major discount store which expected shorter lead time for deliveries. In contrast, several apparel manufacturers in North Carolina noted that their new orders had declined. Contacts in the sector told us that some raw material prices continued to increase--particularly those of oil, lumber, and steel--but they indicated that overall raw material prices were increasing only modestly.

Finance

District bankers reported that loan demand increased somewhat in July and August. Commercial loan demand was spurred by increased merger and acquisition activity and greater commercial real estate investment activity in some areas. A North Carolina banker said that commercial lending had been fairly strong in recent weeks and he expected demand for commercial loans to "surprise people on the upside" in coming months because he expected a pickup in the region's economy. Residential mortgage lending expanded at a moderate pace as attractive mortgage interest rates continued to underpin continued strong demand for both primary and second homes.

Real Estate

Fifth District Realtors reported that while housing activity remained generally strong, home sales slowed in some areas. A Richmond, Va., agent told us the market in his area was vibrant and that homes in all price ranges were selling well. A Realtor in Odenton, Md., said that market was strong as well, with "lots of wonderful inventory," while an agent in Asheville, N.C., noted "good" markets with "a lot of out-of-town as well as local buyers." In contrast, a Realtor in Greensboro, N.C., reported slowing home sales, which he attributed to fewer new businesses relocating to the area, and an agent in Fairfax, Va., said that homes seemed to be staying on the market a little longer.

Commercial leasing activity was generally flat in recent weeks as a typical summer slowdown continued in some Fifth District markets. "Conditions are about the same here, but we expect things to pick up in early September," noted a contact in Raleigh, N.C. However, the seasonal lull didn't persist everywhere. Leasing activity in the Washington metropolitan area picked up dramatically in recent weeks. "Businesses are gearing up to take more space, lots of deals are getting done, and the demand is forcing up rents," reported a D.C. area Realtor. The Columbia, S.C., market was also active and remained one of the hottest markets in the Fifth District. "There is a great energy here in Columbia, leasing continues to pick up, there has even been a recent uptick in industrial and warehouse activity," noted a contact in that area.

Tourism

District tourist activity was mixed in recent weeks. Hurricane Charley forced evacuations in some coastal areas of the Carolinas in mid August, denting tourism revenues in the region. A

contact at Myrtle Beach, S.C., estimated a loss of \$30 million because of evacuations resulting from Hurricane Charley in that area. Tropical Storm Gaston also slowed tourism in South Carolina but the effect was minimal because the brunt of the storm went west of the coast. A real estate agent on Emerald Isle, N.C., said that beach cottage rentals had been slow all summer and that he had taken the unusual step of lowering rents to attract more business. He noted that people were taking shorter vacations this summer and seemed less inclined to rent cottages for an entire week. In contrast, a hotelier at Virginia Beach, Va., reported somewhat stronger bookings in July and August and a 98 percent occupancy rate. A manager at a mountain resort in Virginia was also upbeat, noting that customers were spending more and that bookings were strong through October.

Temporary Employment

Contacts at Fifth District temporary employment agencies continued to report stronger demand for workers in recent weeks. A contact in Hagerstown, Md., said that solid growth in the local economy was creating strong demand for temporary manufacturing and warehouse workers. Most temporary employment agents said that they expected a further strengthening in demand for their workers in the months ahead. Workers with administrative or industrial skills were most widely sought.

Agriculture

Although storms and excessive moisture have led to problems in some areas, District crops are generally in excellent shape. Crops in some coastal regions of the District were buffeted by winds and rainfall from Hurricane Charley and Tropical Storm Gaston in August, but damage was not widespread. Farmers in coastal South Carolina reported some damage to tobacco and corn crops from heavy winds and extremely wet fields. In addition, excessive moisture contributed to higher incidences of diseased fruits and vegetables in Maryland and reduced the quality of tobacco in some areas of North Carolina. Despite the weather-related problems, field crop development was ahead of schedule and pasture and livestock conditions were generally good in most areas. In addition, because of ample rainfall, farmers in many areas anticipated bumper crop yields. But bumper crops may not translate into record revenues; crop producers expressed concern that lower prices could trim their crop receipts at harvest time.

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Sixth District--Atlanta

Business contacts indicated that economic activity in the Sixth District remained positive during July, but noted some unevenness in August, separately from disruptions caused by Hurricane Charley in parts of Florida. District retailers reported that sales were robust in July, and mixed in August. Residential housing activity continued at high levels, although several contacts noted some signs of deceleration in August. Reports on tourism and transportation services were mostly positive. Several manufacturers and transportation service providers reported improved demand conditions. Business contacts noted continued caution overall, but indicated that the prospects for hiring were improving. Employment services reported an increase in the number of permanent placements. Price increases were reported in energy and building materials.

Consumer Spending

District contacts reported that July retail sales exceeded year-ago levels. Most of the stronger reports came from Florida and Georgia retailers who benefited from statewide tax holidays. Reports on August sales were more uneven and several merchants reported that inventories were higher than anticipated. In Florida, pre-storm spending on emergency goods and repair purchases after the hurricane may turn out to be more significant than the direct loss of sales due to the storm. However, significant out-of-pocket repair bills will act as a drag on consumer spending in the effected areas going forward. July and August auto sales in the District improved slightly from previous months, but most dealers reported that inventory levels were higher than expected. Light trucks and SUVs continued to lead sales.

Real Estate

District single-family housing markets remained robust overall during July, but some contacts noted a deceleration during August. Builders reported that home construction was similar to year-ago levels in August, but that new home sales were uneven. Similarly, reports from Realtors indicated that existing home sales in August were mixed. The strongest reports came from Florida builders and Realtors, who also noted that home inventories were still low. Increased building activity associated with the hurricane will likely put additional strain on construction material and labor resources in Florida. Activity in District commercial real estate markets remained at low levels, while modest improvements in leasing activity were noted.

Manufacturing

Continuing strength in residential building helped boost manufacturers of lumber, building supplies, furniture, and carpet during July and August. Rebuilding from hurricane damage in Florida is expected to further stimulate these sectors over coming months. Contacts reported new investment in vehicle assembly and parts manufacturing, and some shipbuilders and aerospace firms were expanding because of military contracts. A paperboard and packaging producer reported an increase in new orders and has added staff as a result. However, employment in the apparel industry continued to slide, and contacts in some other industries reported that they remained cautious about expansion and hiring.

Transportation

Most District transportation contacts reported improving conditions in July and August. Strong demand for trucking services reportedly permitted service providers to pass on higher fuel costs to customers. Some truckers in Georgia and Florida were also busy addressing demands from disaster relief agencies. Domestic and international air transportation services reported strong demand in Atlanta and Miami.

Tourism and Business Travel

Reports from the District's tourism and hospitality industry remained upbeat. Most central Florida tourist attractions closed for only one day because of the hurricane, and damage to the theme parks was reportedly limited. Reports from other parts of the District indicated that bookings for conventions and business meetings for upcoming months were continuing to strengthen.

Financial

Responses from the financial sector were mostly positive. Reports indicated that deposit flows were steady and delinquencies remained manageable. In Florida, several banks offered special financing arrangements, such as deferred loan payments to victims of the hurricane. Storm-related insurance payouts were boosting deposits there as well. In parts of the District, bankers noted improvement in demand for industrial and commercial loans, but most contacts indicated that businesses were continuing to approach expansion and major spending cautiously. Venture capital investment activity in the District remained restrained.

Employment and Prices

District staffing firms reported that the pace of transition from temporary to permanent jobs was accelerating. Demand continued to be particularly strong for healthcare workers. Manufacturers added jobs in the auto and defense-related industries, but apparel firms continued to shed employees. By some accounts, Hurricane Charley's net impact on employment over coming months will likely be modestly positive. Increased hiring in disaster relief services and in construction should more than offset direct temporary layoffs in tourism and retail sectors. Industrial contacts continued to express concern over higher energy costs. For instance, manufacturers of plastics reported that petroleum-based input prices have "skyrocketed" in recent months. Storm-related construction in Florida is likely to put further upward pressure on lumber, cement, and labor costs.

Agriculture

Hurricane Charley caused heavy losses in three of Florida's major citrus producing counties. The USDA estimated that the storm ruined around 20 percent of this year's citrus harvest, including about 10 percent of the orange crop. Futures prices for orange juice increased from recent lows, although high inventories reportedly moderated the size of the increase.

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Seventh District--Chicago

The Seventh District economy continued to expand in late July and August, albeit at a slightly slower pace. On balance, consumer spending appeared to soften somewhat during the period. Business spending continued to increase, but the pace of hiring slowed. Construction activity also decelerated somewhat, but remained robust. Manufacturing activity again expanded solidly. Overall lending activity was relatively soft, despite a slight pickup in residential mortgage applications. Persistently high energy and materials prices were the primary cost concerns among business contacts, but there was little to suggest that these higher costs had become embedded in inflationary expectations. The District's agricultural situation was mixed again, as crop conditions remained well above year-ago levels while most agricultural product prices declined.

Consumer spending

Contact reports were mixed but, on balance, suggested that consumer spending softened somewhat in late July and August. Most retailers indicated that sales results during the period fell short of their modest expectations, with the Midwest a little weaker than other regions. Back-to-school sales generally were described as lackluster and apparel sales continued to languish. Electronics and appliances were among the better performing sales categories.

Retailers said that inventories were relatively lean, in line with their conservative sales expectations. District auto dealers suggested that light vehicle sales had been "fickle" recently, with no clear pattern or momentum. Light truck sales were said to be faring better than passenger car sales. Inventories were still high, even though many auto dealers had cut back orders earlier in the summer. Tourism and related spending remained flat in most of the region. In contrast, theater ticket sales were still brisk.

Business spending

Business spending continued to increase recently, although the pace of new hiring may have slowed somewhat. Reports generally indicated that capital spending for information technology (IT) and other equipment continued to increase moderately, but future spending plans were tempered by caution regarding the economic outlook. Contacts suggested that much of the recent spending was dedicated to replacing existing equipment rather than outright expansion. Business travel and advertising continued to rebound. Freight volumes were also rising again, and industry contacts said that capacity constraints were hindering freight movement in some areas. Many shipping firms, both rail and over-the-road, were boosting capital outlays and adding permanent workers. Manufacturers also appeared to be adding to their payrolls to keep up with production. More generally, however, permanent hiring was still subdued. Temporary help firms said that the number of workers on assignment remained above year-earlier levels, although growth rates had flattened out. With regard to seasonal help, contacts in tourist areas reported that summer help may be furloughed earlier than in previous years, while retailers indicated that hiring for the upcoming holiday season will be even with or lower than last year.

Construction/real estate

Overall construction and real estate activity remained robust in late July and August, although it may have softened slightly. Residential activity appeared to slow in some areas, though Realtors and builders said that home sales remained robust and their "salespeople weren't complaining." On the nonresidential side, office leasing activity was in a typical seasonal lull during August. Contacts also suggested that light industrial activity slowed in some areas. Rents in both segments remained under pressure as landlords were willing to "sacrifice rent for occupancy." By contrast, retail development and leasing activity remained brisk. Construction professionals from around the District have reported limited impact from shortages of some materials (such as cement) that have persisted in other regions of the nation.

Manufacturing

Manufacturing activity continued to expand solidly, boosted by strong demand for capital goods and materials. Producers of heavy machinery reported that production continued to increase and backlogs were up. New orders for heavy equipment remained firm, despite some recent softening. Manufacturers of heavy trucks also noted a "strong ramp-up in production," with one saying that increases in output were limited by shortages of some parts, including engines. New orders for heavy trucks recently backed off from "irrationally exuberant" levels, but remained robust. Strong demand for steel and gypsum wallboard continued, with both industries running near capacity. Steel inventories were up slightly, but remained lean. Many steel producers and service centers were reluctant to increase inventories further because they expected steel prices to fall from current lofty levels. Small

manufacturing firms from a diverse set of industry groupings reported that new orders and production remained much higher than a year earlier. The active housing market continued to boost demand for home appliances. Light vehicle demand nationally was firm, but August sales were running slightly below manufacturers' expectations. Inventories were still elevated, but automakers had made only minor adjustments to their production schedules.

Banking/finance

Lenders generally reported a slight pickup in household loan activity, but persistent softness in business lending. Many bankers noted a slight increase in residential mortgage lending, a result they attributed to lower mortgage interest rates. However, applications for other types of household loans were flat. Standards and terms on household loans were largely unchanged and credit quality continued to improve. On balance, business loan volumes showed little, if any, increase. Many firms continued to use cash to meet their short-term liquidity needs, rather than borrowing. However, lenders also suggested that some firms had become more uncertain of economic activity going forward. Covenants on business loans changed little from our previous report, although some banks were reportedly lowering standards to "chase deals that don't exist" because of weak demand. Measures of business credit quality continued to improve.

Prices/costs

Higher oil prices were the primary cost concern for many businesses. Many contacts were concerned, disappointed, and surprised that energy costs had not yet retreated. Some firms (such as freight haulers) were able to pass along these higher costs in the form of surcharges and/or higher prices, while others (such as airlines) had less success doing so. Reports also suggested that oil prices were driving up the cost of plastics, rubber, and other petroleum-based materials. Firms continued to use surcharges to recoup the higher costs of steel, although outright price increases remained subdued. While higher energy and materials costs have persisted longer than expected, there was little evidence to suggest that they have become embedded in producers' inflationary expectations. Price increases at the retail level remained benign. Many retailers said that the pricing environment had actually become more competitive during the reporting period, and were expanding discounts to include more key merchandise. Wage increases were again subdued, but rising nonwage labor costs remained a concern for many employers.

Agriculture

Agricultural producers faced atypical weather patterns during the reporting period. Precipitation was scattered, although moisture levels were adequate in most of the District. In addition, unseasonably cool temperatures delayed crop growth and contributed to an increase in localized crop disease and pest problems. Overall, crop conditions deteriorated slightly, but remained much better than last year when there was significant late summer deterioration. Crop development and conditions continued to lag the norm in northern parts of the District, but were again better than normal in southern sections. A bumper harvest is still possible in some areas if seasonal temperatures prevail, but an average harvest is the best that other regions could experience. Prices of many agricultural products fell during the reporting period, including those for corn, soybeans, hogs, milk, and beef. Elevated energy prices have contributed to an increase in drying costs at grain elevators, adversely affecting farmers as the harvest approaches. Land values flattened in some parts of the District, while

they increased more slowly in other portions.

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Eighth District--St. Louis

Economic conditions in the Eighth District continued to improve slowly since our last survey. Many firms in the manufacturing and services sector reported expansions and new hiring. Some contacts, however, reported closings and layoffs. Retail sales in June and July decreased compared with year-earlier levels. Car sales increased over the same period. Residential real estate markets continued to do well, and commercial markets showed additional signs of improvement. Overall lending conditions at a sample of District banks were mostly unchanged in the three months ending in July.

Consumer Spending

Contacts reported that retail sales in June and July were down about 2.5 percent, on average, over year-earlier levels. While 56 percent of the retailers surveyed noted that sales levels met their expectations, 35 percent reported that sales were below what they had anticipated; 9 percent reported sales above expectations. Electronics, women's apparel and accessories, jewelry, and computers were all strong sellers, while home accessories, gift items, and children's apparel were moving more slowly. Nearly 70 percent of contacts noted that inventories were at desired levels. Retailers appear generally optimistic about sales in the fall, and more than 80 percent of contacts are hopeful that sales will increase over 2003 levels.

Car dealers in the District reported that, compared with last year, sales in June and July were up about 3.5 percent, on average. About 44 percent of the car dealers surveyed reported increases in sales, while another 44 percent reported decreases. About 33 percent of the car dealers noted that new car sales had increased, and more than half reported increases in low-end vehicle sales. About 57 percent of the contacts reported increased use of rebates, while 33 percent reported no change. Approximately 35 percent of contacts reported a decrease in the acceptance rates of finance applications, while 12 percent reported an increase in acceptance rates. About 32 percent of the car dealers surveyed reported that their inventories were at desired levels, while 48 percent reported that their inventories were too high. Nearly 70 percent of the car dealers surveyed expect increasing sales this fall.

Manufacturing and Other Business Activity

Manufacturing activity in the Eighth District continued to expand in many areas since our last report. Firms in the window and door, small engine, aerospace, and home appliance manufacturing sectors reported plant expansions that, in total, included hiring 1,100 new employees. Firms in the steel, recycling, and processed foods sectors reported new plant openings that included hiring new employees. A District aluminum manufacturer employing over 500 workers cancelled the sale of its plant and decided to continue operations. Despite reports of plant expansions and openings, some District manufacturers reported plant closures and workforce reductions. Firms in the home fixtures, furniture, and electronic cable manufacturing sectors will close plants, which may result in as many as 1,300 displaced workers.

The District's services sector has improved in many areas. Firms in the aviation, consumer

products distribution, freight transportation, travel and tourism, general retail, and health care services sectors reported expansions and new hiring. In contrast, firms in the banking and education services sectors reported office closures and workforce reductions. An automotive maintenance and repair services union group is on strike in the St. Louis area. Car dealers suggested that, although the strike has not affected vehicle sales, it has negatively affected maintenance and repair services at the dealerships where workers are striking.

Real Estate and Construction

Sales of single-family homes continued to increase throughout the District. Memphis posted record sales in July, with year-to-date sales increasing 25.6 percent compared with the same period in 2003. The increase in July year-to-date sales was 5.5 percent for the greater St. Louis area and 7.9 percent for Louisville compared with July 2003. Southern Indiana had a 15.4 percent increase in its June year-to-date sales compared with the same period last year, while Madison County in Illinois had a 20.9 percent increase. July year-to-date single-family housing permits were up in most of the District's metropolitan areas compared with July of last year. Year-to-date permits through July in the greater St. Louis area increased by 23.3 percent in July compared with the same period last year. Home construction in July increased by 31 percent in the Louisville metro area compared with July 2003, and contacts in southern Indiana and north central Arkansas reported that construction is still increasing in these areas.

The office and industrial real estate markets are improving slowly in most of the District. The overall office vacancy rate in Louisville's central business district fell to 20.3 percent in the second quarter from 21.4 percent in the first quarter. Both office and industrial vacancy rates decreased slightly in the greater St. Louis area compared with this year's first quarter. The overall vacancy rate fell to 16.8 percent from 17.1 percent, and the overall industrial rate fell to 6.6 percent from 6.8 percent. Commercial construction is also improving in most of the Eighth District. Contacts in southern Indiana noted that commercial construction has remained stable and that it is still growing in north central Arkansas.

Banking and Finance

A survey of senior loan officers at a sample of District banks indicated little change in overall lending activity in the three months ending in July. During this period, credit standards and demand for commercial and industrial loans remained unchanged for both large and small firms. Credit standards and loan terms for commercial real estate loans remained basically unchanged, while the demand for these loans showed some indication of being moderately stronger. Meanwhile, both the credit standards and the demand for residential mortgage loans, credit cards, and other consumer loans were generally unchanged.

Agriculture and Natural Resources

Dry conditions and cooler-than-normal temperatures have slowed the development of soybeans and cotton in some parts of the District. Corn and soybean development in each District state remains on pace with or ahead of their five-year averages. The corn harvest has begun in southern regions of the District. The pace of cotton growth in the District and the pace of sorghum growth in Missouri have fallen behind normal. District crops, including corn, soybeans, sorghum, cotton, rice, and tobacco, are mostly in good condition; however, some soybean fields in Illinois, Indiana, and Missouri suffer from Sudden Death Syndrome, a fungal disease. Pastures throughout the District would benefit from more rain, and livestock remains in good condition.

Ninth District--Minneapolis

The economy in the Ninth District grew moderately from mid-July through late August. Growth was noted in manufacturing, mining, energy, and consumer spending. Conditions were mixed in tourism, steady in real estate and construction and down in agriculture. District labor markets tightened somewhat from the last report and wage increases were moderate. While overall price increases appear to have been moderate, significant increases were noted for building and manufacturing materials and energy-related products.

Construction and Real Estate

Overall commercial construction activity remained unchanged, although signs of a pickup were noted. A construction association representative in the Upper Peninsula of Michigan said that construction was stable. A general contractor with projects in southern Minnesota and South Dakota said that the summer season was similar to a year ago. Government spending on construction was weak in Montana, but recent increases in government revenue might help, according to a contractors association representative. Contracts awarded for large projects in Minnesota and the Dakotas were up 4 percent for the three-month period ended in July compared with a year ago. An official in Sioux Falls, S.D., noted solid construction activity in both commercial and residential markets and anticipates a record year.

Home building and residential real estate were about even with last year's robust activity. Housing units authorized in district states were level for the three-month period ended in July compared with a year ago. An official in Billings, Mont., described the summer building season as about the same as a year ago. A Realtor in the Minneapolis area reported strong sales; however, home sales were down slightly in July compared with a year ago. In western Montana, a bank director reported solid residential real estate activity, particularly sales of condos.

Consumer Spending and Tourism

Overall consumer spending was up moderately. A major Minneapolis-based retailer reported same-store sales during August were likely to be on target--zero to 2 percent higher than a year ago. Summer traffic at a Minneapolis area mall was up nearly 6 percent from last year. Back-to-school traffic and sales at a North Dakota mall were strong, according to the mall manager.

A representative of an automobile dealers association in South Dakota noted that recent vehicle sales were solid, though perhaps slightly down from a year ago.

Summer tourism activity was mixed as cool weather put a damper on travel in some areas. Cool weather slowed travel to northern Minnesota, particularly through mid-July, said a chamber of commerce official. In South Dakota the number of summer visitors appears to be down from last year's strong levels, but those who came were spending robustly, according to a tourism official. In northwestern Wisconsin the number of tourists was up, and the cool weather encouraged more visits to restaurants and retailers near tourist destinations. A bank director noted that summer tourism in western Montana was better than a year ago; the total number of passengers at airports was also higher than last year.

Manufacturing

Manufacturing activity jumped. Preliminary results from a survey of district manufacturers conducted in late July and August by the Minneapolis Fed and the Minnesota Department of Employment and Economic Development revealed that businesses expect production, productivity and profits to increase in the second half of 2004 from a robust first half.

"Things are good and getting better," commented a respondent from a small Minnesota company. In addition, an August survey of purchasing managers by Creighton University (Omaha, Neb.) indicated overall improved manufacturing activity in the Dakotas and Minnesota. A window and door company announced plans to expand production at a North Dakota facility, and new plants are expected for a hovercraft maker and specialty manufacturer. A metal stamping factory in Minnesota is adding work shifts. A manufacturer in the Upper Peninsula noted strong growth in demand and higher input costs.

Energy and Mining

Activity in the energy and mining sectors remained strong. Mid-August district oil production increased from mid-July. Recent increases in oil prices have encouraged more drilling activity in the district. Iron ore mines continued to produce at capacity, and a company plans to expand production by 40 percent at a mine in northern Minnesota. The operating mines in Montana produced at near capacity, and a silver/copper mine in Montana plans to reopen by the end of the year. There is interest in opening other closed mine sites and "prices are steady and at a good price," said a Montana mining official.

Agriculture

Agricultural conditions decreased since the last report. An August frost damaged crops in the northern portions of the district, and continued cool weather hindered crop growth. An early hard frost caused significant damage to crops in several counties in Minnesota. Crop progress was significantly behind last year's pace and the five-year average for most district crops. August South Dakota cattle in feed lots were down significantly from July levels. However, lenders responding to the Minneapolis Fed's second quarter (July) agricultural credit conditions survey expected that overall agricultural income would rise in the third quarter.

Employment, Wages, and Prices

Labor markets tightened somewhat since the last report. Seasonally adjusted nonfarm employment was up slightly in July from June in district states but was 1 percent higher than July last year. Initial claims for unemployment insurance in Minnesota were down 19 percent in July compared with a year ago. The number of job vacancies in Minnesota increased to 5.1 vacancies per 10 unemployed people in the second quarter from 3.5 a year earlier. A recent survey by St. Cloud State University (Minn.) of employers who recruit on state campuses noted that all respondents plan to maintain or increase hiring next year. Employers in northwestern Montana noted that finding people to fill some job openings was becoming more of a challenge.

New job announcements included a medical claims company that plans to employ 250 workers in Montana. A window manufacturer in Minnesota was in the process of hiring 300 people, many in temporary positions. In contrast, a Minnesota folding-carton plant will close in December with job losses estimated at 170, a Montana call center laid off 50 employees,

and a Wisconsin computer company eliminated 25 positions.

Wage increases remained moderate. A recent contract agreement with workers at mines in Minnesota and the Upper Peninsula included a 9 percent wage increase over the next four years; however, employees and future retirees will share a greater percentage of their health care costs. Sugar beet workers in western Minnesota will receive annual pay raises of 2 percent over three years and will pay only small increases in medical deductibles, according to a recent agreement. Wages for hired workers on farms in Minnesota, Michigan, and Wisconsin were down slightly in July compared with a year ago.

While overall price increases appear to have been moderate, significant increases were noted in manufacturing and building materials and energy-related products. According to the aforementioned Minneapolis Fed survey of manufacturers, 37 percent expect to increase product prices during the second half of 2004, while 8 percent expect to decrease prices. A number of manufacturers and contractors noted higher costs for materials, such as copper, iron, gutters, and carpet. Energy prices were generally higher, including the expected costs to heat homes with natural gas. Diesel fuel prices were recently up 25 percent compared with a year ago. However, gasoline prices in Minnesota near the end of August were up only 3 percent from a year earlier.

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Tenth District--Kansas City

The Tenth District economy expanded moderately in late July and August. Consumer spending rose somewhat after flattening earlier in the summer, and labor markets showed further modest improvement. In addition, manufacturing activity and energy activity continued to increase, and agriculture and tourism remained solid. Housing activity eased slightly but was still strong, while commercial real estate remained weak. Wage and price pressures increased slightly but remained modest.

Consumer Spending

Consumer spending in the district improved somewhat in late July and August after flattening in the previous survey. A majority of retailers reported increases in sales from earlier in the summer, while only a handful of stores reported declines. Sales were also above year-ago levels at most stores. Among product categories, sales of back-to-school items--including children's apparel--were up solidly from previous years, and sales of home furnishings were generally reported as strong. A few stores, however, noted some reluctance by consumers to purchase big ticket or luxury items. Most store managers were satisfied with inventory levels. However, a few stores still needed to trim inventories due to sluggish sales earlier in the summer, while a number of others were having difficulty keeping shelves stocked due to strong sales. Heading forward, nearly all retailers anticipate higher sales through the fall, though some noted that their outlook depended on consumer confidence levels. Like other retail sales, motor vehicle sales in the district improved slightly in late July and August and were back to year-ago levels in most places. Several dealers reported strong increases in sales of imports, and truck sales were generally reported as solid. By contrast, sales of full-size SUVs were reported as soft by many dealers. Nearly all dealers were satisfied with inventories and anticipate solid sales gains in the months ahead. However, several contacts noted that sales growth could be held down for a few months by uncertainty

about the economy and the tendency of some buyers to postpone major purchases until after the election. Travel and tourism activity in the district was generally solid in late July and August. Hotel occupancy rates in most areas were up modestly from the previous survey. Airport traffic was down slightly in most cities from earlier in the summer but still above year-ago levels throughout the district.

Manufacturing

District manufacturing activity expanded further in late July and August. Most manufacturers continued to report that they were operating at high levels of capacity utilization and that production continued to rise solidly. Some firms also added workers and increased hours. A few plants had trouble obtaining materials, as supplier delivery times increased due to trucking firms' difficulties meeting high demand. Heading forward, most plant managers anticipate continued strong production activity--in part to work off record backlogs but also to fill new orders. Many firms also plan new investments in plant and equipment as well as further increases in employment.

Real Estate and Construction

Housing activity eased slightly but was still generally strong in late July and August, while commercial real estate remained weak. Single-family housing starts edged down in many cities and were also slightly below year-ago levels in a majority of areas. Even so, nearly all builders still characterized new home construction as strong. Building materials were generally available, but several builders said they were concerned about future shortages due to the rebuilding necessary after Hurricane Charley. Builders generally expect construction activity to remain solid in the months ahead. Most residential realtors reported flat home sales compared with the last survey, although sales remained high by historical standards. The strongest sales were reported for mid-level homes. Realtors generally expect some easing in home sales heading forward. Commercial real estate activity was weak in late July and August. Vacancy rates were flat in Denver and Kansas City and were up slightly in some other areas. Commercial realtors generally expect little change in office conditions in coming months.

Banking

Bankers reported that loans edged up and deposits held steady since the last survey, raising loan-deposit ratios slightly. Demand for home mortgages and home equity loans increased slightly, while demand for other categories--including commercial and industrial loans--was little changed. A few respondents said strong cash flow was causing some businesses to rely more heavily on internal financing, limiting their demand for bank loans. On the deposit side, all types of accounts held steady. Almost all respondent banks raised their prime lending rates and consumer lending rates since the last survey. Lending standards were generally unchanged.

Energy

District energy activity rose further in late July and August. The count of active oil and gas drilling rigs in the region increased slightly from the previous survey and was up strongly from a year ago. Several producers continued to report constraints on drilling due to labor and equipment shortages, and one firm noted that drilling in some locations could become unprofitable if prices for steel tubing continue to escalate. Another contact, however, said oil

prices were approaching sufficiently high levels that some alternative oil sources--such as oil tar sands--might become financially viable, and energy contacts in general anticipate continued modest increases in drilling heading forward.

Agriculture

Agricultural conditions in the district generally remained solid in late July and August, though abnormal weather hurt crop conditions somewhat. The winter wheat harvest was smaller than a year ago, and wet harvesting conditions caused some concerns about crop quality. The unusually cool and wet weather also raised concerns about whether spring-planted crops had developed sufficiently to survive a possible early frost. In the cattle market, pasture conditions improved, but herd expansion is expected to be limited by higher costs of acquiring cattle. Cropland values have continued rising, and bankers and producers expect overall farm incomes this year to be at or above last year's high levels.

Wages and Prices

Wage and price pressures increased slightly in late July and August but remained modest. Labor markets showed further modest improvement, as hiring announcements continued to exceed layoff announcements and several large manufacturers in the district recalled furloughed workers. Most firms continued to face few wage pressures. However, a number of energy, trucking, and health care firms were offering higher-than-normal wage increases to keep or attract workers. There were also more worker shortages reported in the manufacturing and retail sectors, causing some increased wage pressures for select occupations. Most retailers reported flat selling prices and expect prices to remain stable heading forward. However, sellers of furniture and flooring reported further price increases due to higher wholesale prices for these products, and some retailers increased charges for deliveries due to higher fuel costs. Although a majority of manufacturers continued to report rising materials costs, there were fewer reports of increases than in past surveys. A slightly higher percentage of firms reported raising their output prices than in the previous survey. However, this increase came solely from producers of steel products and the overall share of firms raising prices was still smaller than in the spring.

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Eleventh District--Dallas

Eleventh District economic activity continued to expand from mid-July to late August. Manufacturing activity was mixed, but demand for business services continues to increase modestly. Retail sales softened some. There was little change in construction or financial services activity. There was only a slight increase in energy activity, a much weaker response than might be expected given the high energy prices. Agricultural conditions continue to be favorable.

Contacts remain optimistic about the outlook for the rest of the year, but many are less enthusiastically optimistic than they were a few weeks ago. Many contacts said they are looking forward to getting past the Presidential election, hoping for reduced uncertainty.

Prices

There continue to be reports of price increases for manufactured products, such as paper and

processed food. Some energy prices were also higher. A number of factors pushed up crude oil prices over the past few weeks but gasoline and natural gas prices have softened some.

Demand for crude oil has been strong from both the U.S. and China; Chinese oil imports are up 40 percent over a year ago. The International Energy Agency made a sweeping revision of its energy consumption statistics, revising upward both recent and forecast figures. With OPEC near full capacity, fears of potential supply disruptions also played a role in pushing up oil prices, with various estimates of the "fear premium" placed at \$10 to \$15 per barrel. Fighting in Iraq, sabotage of Iraqi oil facilities, bankruptcy of Russian oil giant Yukos, recall elections in Venezuela, and severe tropical weather all added to uncertainty in the market about oil deliveries in a tight market.

Gasoline prices peaked in mid-July at both the wholesale and retail levels. Heating oil prices have begun a normal seasonal rise, but are about 20 cents per gallon above year ago values. Inventories of distillates--including heating oil--have now risen back to near normal levels over the summer.

Natural gas prices were near \$6 per million Btu in mid-July, but have trended downward to near \$5.25. Mild summer weather has kept air conditioning loads at low levels, and the forecast is for continued mild weather through September. Inventories have been filling ahead of schedule, and will easily refill to capacity for the winter heating season. The futures market has built in a potential seasonal increase to \$7 natural gas over the winter.

Manufacturing contacts are concerned about high fuel prices driving up the cost of raw materials, production and shipping. Manufacturers' ability to pass on cost increases remains limited, cutting into profits. Some manufacturers also expressed concern that continued high energy prices would cut into demand for their products because customers would be forced to spend more on fuel.

Labor Market

The labor market continues to strengthen with scattered reports of hiring in both manufacturing and the service sector. Some firms reported upward wage pressure, and a few reported difficulty finding qualified workers. For example, the trucking industry reports a shortage of qualified drivers. Many firms expressed concerns about rising medical costs, but some noted that the rate of increase is slower than it was a year ago.

Manufacturing

Manufacturing activity was mixed. Sales for food products have weakened over the last several months, which contacts attribute to higher prices for food and gasoline. Manufacturers of stone, clay and glass continue to report steady demand. Demand for lumber is unchanged. Paper producers say there has been some softening in sales because their customers built up their inventory of boxes and packaging in anticipation of higher prices.

Respondents in high-tech manufacturing report that orders picked up slightly in the second half of August after slowing in the previous six weeks. The increase was due mainly to a rise in commercial and industrial demand as companies increased orders for computers and other electronic equipment. Contacts say that products inventories are lean, with the exception of those in China. Telecomm manufacturers say demand is unchanged. Prices continue to decline, although at a slightly slower pace.

Demand is unchanged for primary and fabricated metals. Input prices are rising because the Chinese are buying up a lot of scrap metal, the dollar is weaker and energy costs are higher. Cost pressures are being pushed through to selling prices for some products.

Chemical demand remains very strong for most products, and price increases are widespread. Nitrogen, polypropylene, PET bottle resin and caustic soda are among products with notable price increases driven by strong demand. Prices for other products, such as for benzene, are rising due to higher feedstock costs. Suppliers to the industry report high levels of capacity utilization and, for the first time in several years, an interest in expanding capacity along the Texas Gulf Coast.

Gasoline consumption has slowed with higher prices over the summer. Imports of gasoline have surged over the summer, and gasoline inventories moved from the bottom of the 5-year range to the top. Refiners now report that falling gasoline prices and rising crude prices have squeezed once sizable margins, cutting them in half since mid-May along the Gulf Coast.

Services

Accounting firms report that demand has not changed from its high levels. Contacts say firms are swamped with work related to new regulations put in place by the Sarbanes-Oxley Act and the SEC. Salaries are up 3 percent to 5 percent.

Temporary staffing firms say activity has softened some, but demand remains above a year ago. Demand is strongest for temporary manufacturing workers. Higher costs and stiff competition continue to erode profit margins. Demand for legal services is still strong and increased slightly in the last month, driven mostly by demand from corporate customers.

Transportation firms report strong activity. Airlines report high load factors but an inability to earn profits because of industry-wide overcapacity, stiff competition, and high fuel prices. Railroad transportation hit record levels in August, leading to some additional congestion and capacity issues. Railroads have increased prices and demand continues to rise. Future expansion plans include purchasing more locomotives and bigger railcars to meet demand. Trucking activity remains strong, but companies continue to voice concerns about higher fuel costs.

Retail Sales

Retail sales have been mixed, with some respondents being disappointed by the pace of sales growth over the past few weeks. Sales were weakest for retailers that serve lower income customers, and contacts conclude that high energy prices are impacting these consumers the most. High energy costs are also a concern for retailers, and some say they are making investments to control and reduce their energy consumption. Automobile sales in the District continue to slip, particularly for SUVs and less fuel-efficient vehicles.

Construction and Real Estate

Homebuilding remained steady, with the exception of a normal back-to-school-lull. Strong competition and rising costs continue to squeeze margins. Existing home markets in most major Texas metros remained lively in August, following record-breaking sales in June and July. Still, median home prices have not appreciated much this year. Contacts in the

residential sector are cautious about the outlook, hoping that a pickup in job growth will buoy housing demand if mortgage rates edge up. Apartment markets continue to suffer as construction slightly outpaces the growth of demand.

Commercial construction continues to be driven by public works. High office vacancies have put a lid on private office construction, but there are some signs of recovery in hotel construction, according to respondents. Demand for office space is picking up slowly, and contacts noted that tenants were expanding their leases in expectations of an improved economy. Retail space remains the healthiest market segment for most real estate contacts.

Financial Services

Financial services activity continues to improve steadily. Demand for consumer and commercial loans remains good, but there is beginning to be slowing for home financing. Deposit growth remains flat, and contacts hope eventual interest rate increases will lead to more deposits. Most respondents say that, while lending is strengthening, it is not to a level that would squeeze current funds availability. Competition for loans and deposits remains stiff. Contacts say that the Texas retail market is underserved and expect the rapid expansion of branches and new bank entry to continue.

Energy

Higher energy prices moderately pushed up drilling activity but there was little change in demand for oil services and machinery. Contacts continue to report that higher oil and gas prices are adding to cash flow for producers but are not leading to a significant increase in exploration budgets. The Texas rig count is up about 20 rigs over the past six weeks, after having remained at about 500 working rigs since last April. Activity in the Gulf of Mexico is unchanged. The international rig count fell sharply in July, but contacts say the drop was an anomaly and did not reflect a fundamental change in the outlook.

Oil service companies report that business is busy and profitable but subdued given current energy prices. Prices for oil field equipment and services were up in the second quarter, but most of the increase was tied to higher costs for steel and copper, rather than capacity limitations in producing the equipment.

Agriculture

Overall crop conditions for corn, cotton, peanuts and sorghum are better than a year ago. Rangeland and pastures are in fair condition, with supplemental feeding unnecessary. Wet weather conditions in some parts of the district disrupted harvest, slowed crop progress and delayed hay cutting and baling activity. There were some reports of cotton crop losses and damage due to hail in the South Plains.

Feeder cattle markets have been a little sluggish in recent weeks; a drop in the price for imported chicken has reduced beef demand, according to contacts. Prices of feeder cattle are expected to remain soft until the end of September 2004.

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Twelfth District--San Francisco

Reports from contacts indicate that economic activity continued to expand at a solid pace in most parts of the District in late July and August. In recent weeks, contacts cited selected pockets of price inflation, notably for energy, construction supplies, and steel. Wage pressures remained modest but up slightly overall, boosted by tight supplies of higher-skilled workers. Retail sales remained strong, as did the demand for services. Manufacturing activity reportedly picked up for a variety of products. District providers of agricultural and resource products reported generally solid demand. Residential real estate activity remained robust, although there were some scattered hints of softening. Demand for commercial real estate was stable. District banks reported solid loan demand and good credit quality.

Prices and Wages

District contacts reported pockets of escalated prices, mainly in the areas of energy and construction supplies during the most recent survey period; cement, concrete, steel, and lumber prices increased sharply. However, prices at retail stores were reported to be flat. Wages and salary pressures remained modest but up slightly overall, with reported wages for low-skill jobs being stagnant and wages for some highly sought skilled occupations, such as nursing and IT professionals, having increased. Respondents in all sectors reported that rising health insurance costs contributed significantly to increases in overall compensation costs.

Retail Trade and Services

District contacts indicated that retail sales were strong in late July and August. Automobile dealers reported a slight improvement in overall sales in recent weeks, especially for foreign brands. Increased incentives have been placed on domestic models to help reduce inventories.

Business conditions for District service providers remained robust. Demand for advertising, media, and health-care services continued to rise. High volumes of international trade have kept several District seaports operating at capacity, which in turn has translated into increased demand for dockworkers and rail services. Conditions in the District travel and tourism sector generally were strong. Hotel occupancy rates continued to rise in Hawaii, California, and other District markets. Increases in both domestic and international visitors boosted the tourism sector in Hawaii.

Manufacturing

Demand conditions in the District's manufacturing sector generally improved during the most recent survey period. Sales and new orders of semiconductors rose, and capacity utilization edged up further. Inventories of chips rose modestly and prices were flat. Lumber manufacturers faced strong domestic and foreign demand and reportedly operated close to full capacity; consequently, prices for wood panels, containerboard, pulp, and other wood products increased substantially. Contacts reported that the conditions in the commercial aircraft sector improved, as new orders from Asia offset a paucity of domestic and European orders. The availability of some inputs remained uncertain in recent weeks; several manufacturers noted that prices for steel and other metals rose sharply as a result of short supply.

Agriculture and Resource-Related Industries

District providers of agricultural and resource-related products reported continued solid demand. Boosted by foreign demand, sales of a variety of District agricultural products have been strong, especially tree nuts. The weather has been conducive to good harvests and yields. In the resource sector, contacts indicated that electric utilities are making investments to expand generation capacity to catch up from past underinvestment. Prices for natural gas remain high.

Real Estate and Construction

District residential real estate markets generally remained robust during the most recent survey period. However, reports from southern California indicated scattered hints of some softening; contacts reported that the amount of time needed to sell the supply of houses on the market rose slightly in some areas and that the pace of home price appreciation has begun to slow. On the commercial side, demand conditions were little changed, and prices and rental rates remained largely flat.

Construction activity generally was robust in most areas, particularly in Hawaii, where the Department of Defense has begun renovations of military housing. Respondents reported that shortages of some building materials, such as steel and cement, increased construction costs and caused construction delays in some cases.

Financial Institutions

District banking contacts reported generally solid loan demand and good credit quality in late July and August. Demand for business lending continued to improve in most areas in the District. Similar strength was evident in commercial real estate lending, where respondents observed increased interest by investors in commercial real estate loans. In contrast, demand for mortgages to finance home purchases weakened slightly. Finally, a majority of District banks surveyed added employees in recent weeks and plan to continue hiring.

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