The Federal Reserve Board

The Beige Book

October 27, 2004

Summary of Commentary on Current Economic Conditions by Federal Reserve District

Summary

Prepared at the Federal Reserve Bank of Chicago based on information collected before October 18, 2004. This document summarizes comments received from businesses and other contacts outside the Federal Reserve System and is not a commentary on the views of Federal Reserve officials.

Reports from the twelve Federal Reserve Districts generally indicated that economic activity continued to expand in September and early October. Boston, Philadelphia, Chicago, Minneapolis, and Kansas City noted continued expansion in economic activity. Richmond and Dallas said the pace had quickened, while New York, Cleveland, and San Francisco suggested that growth had moderated somewhat. St. Louis received mixed reports on economic activity, and Atlanta cited widespread hurricane-related disruptions. Many reports suggested that higher energy costs were constraining consumer and business spending.

Reports on consumer spending in September and early October were mixed by District and spending category. In contrast, business outlays appeared to pick up in most regions, with modest increases in both capital spending and hiring. Residential real estate activity remained robust in most Districts, although it slowed in some. Nonresidential activity was still relatively weak across the nation, though there were scattered signs of improvement. Manufacturing activity increased further since the last Beige Book. Household loan demand seemed to soften somewhat, but business loan demand picked up. Businesses in most Districts continued to express concern over the rising costs of energy and other inputs, although more manufacturers and business service providers were reportedly able to pass part--if not all--of these cost increases along to their customers. However, increases in wages and retail prices generally were subdued. Fall harvests were ahead of the normal pace, and yields of corn and soybeans were expected to set records in some Districts. Energy-related activities continued to increase, despite some disruptions caused by Hurricane Ivan.

Consumer spending/tourism

Consumer spending in September and early October was mixed by region and category. Many Districts indicated that retail sales were soft during the reporting period, while others noted modest improvement. Apparel sales were mixed across the nation. Unseasonably warm temperatures were blamed for weak sales of fall merchandise in the Cleveland, Chicago, and Minneapolis Districts. Hurricanes disrupted retail activity in the Atlanta District, though they did provide a boost to sales of building materials. Most retailers appeared content with inventory levels heading into the holiday shopping season. Light vehicle sales were strong in many Districts during September, although they dropped off in early October. Boston, New York, and San Francisco reported strong tourism activity, but Atlanta said that tourism "took a substantial hit because of the hurricanes." Contacts in many Districts said that high energy costs were constraining household spending, and some said the presidential election was heightening uncertainty among consumers.

Business spending/hiring

On balance, capital spending appeared to pick up modestly. Philadelphia, Chicago, and Kansas City reported that manufacturing firms increased their capital outlays, while Cleveland and St. Louis said that spending was mixed by industry segment. Chicago added that special factors, such as expiring tax incentives and changing environmental regulations, contributed to higher capital outlays. Several Districts reported strong demand for transportation services, and shipping companies were said to be purchasing equipment to keep up with rising freight volumes. With regard to other business spending, Philadelphia noted an increase in technology spending while Chicago and San Francisco reported gains in advertising.

Hiring activity varied by region and industry, but appeared to increase modestly. Nearly half of the Districts said that demand for temporary help increased since the last Beige Book, although momentum slowed in some areas. Reports of permanent hiring became more frequent, notably in manufacturing industries. Five District reports suggested a general increase in manufacturing jobs, while none indicated an outright decline. Boston noted some "sizable increases" in retail employment, and Richmond said that a broad array of service-producing firms were adding workers. Hiring reportedly improved in financial services (New York and Minneapolis) and transportation (Dallas) as well.

Some Districts continued to report isolated shortages of workers in particular occupations such as skilled manufacturing (Boston, Chicago), truck drivers (Cleveland), and upper-level finance occupations (Minneapolis). In addition, some Districts noted signs of more broad-based firming of labor markets. New York said "there are fewer people seeking (office worker) positions;" contacts in the Richmond District suggested there were "fewer qualified candidates to fill permanent positions;" Chicago noted there were "fewer applications for open positions;" and Minneapolis indicated that "labor markets have tightened for a number of industries."

Construction/real estate

Residential construction and real estate activity was robust again in September, although it appeared to soften further from the last Beige Book. New York was the only District to report a general increase in housing market activity. Boston and Kansas City said that sales of high-end homes had softened, and Cleveland reported weakness at all price points. Home prices continued to increase at a healthy pace in most areas. However, a Realtor in Minneapolis suggested some slight price reductions, and homebuilders in the Cleveland and Dallas Districts reportedly raised incentives and/or lowered prices to spur demand.

On balance, nonresidential activity remained weak in most Districts, but there were scattered signs of improvement. Chicago and Dallas noted some pickup in office markets, and Cleveland reported particular strength in the light industrial segment. The Richmond and Chicago Districts said that retail real estate activity remained robust.

Manufacturing

District reports suggested that manufacturing activity expanded further from the previous Beige Book. Reports ranged from solid expansion in the Richmond, Chicago, and Kansas City Districts to decidedly mixed in St. Louis. Hurricanes caused some production disruptions in the Atlanta and Dallas Districts. Stronger activity was evident across a wide array of industry segments, though, on balance, producers of durable goods exhibited more strength than producers of nondurable goods. A number of Districts reported continued strength in metals production, Richmond and Dallas noted improvements in petroleum-based products (such as plastics and petrochemicals), and Chicago said that demand for heavy equipment was still very strong. Demand for high-tech goods was mixed. Boston and San Francisco noted some softening in their semiconductor industries, but Dallas said that strong orders for consumer electronics helped boost demand for semiconductors. The September surge in light vehicle sales helped bring bloated inventories down to more desirable levels. Still, Cleveland pointed out that domestic automakers had announced production cuts.

Banking/finance

Loan demand followed a pattern similar to that reported in the last Beige Book; the household sector softened a bit while loan demand from businesses strengthened somewhat. The moderation on the household side largely reflected a decline in mortgage applications. While new originations were holding up in most Districts, refinancing activity fell off. There were no changes reported in standards and terms for household loans, and credit quality continued to improve. Many Districts indicated that business borrowing had increased; New York was the only District to note a slowdown in business lending and tighter standards on business loans. In general, business loan quality remained high and even improved in the Cleveland and Chicago Districts.

Prices/employment costs

Wage pressures generally remained stable, according to most District reports. Contacts in the Chicago District, however, said that wages continued to trend higher and, for the first time in several years, some firms had begun paying hiring and retention bonuses again. In addition, there were scattered reports of wage increases in occupations where workers were in particularly short supply, such as truck drivers and skilled tradespeople. Kansas City noted that firms in energy drilling activities had raised wages 10 percent or more to attract entry-level workers. Contacts in much of the nation continued to express concern about high benefits costs, most notably for health insurance.

Firms across the nation also expressed concern about higher input costs, particularly for energy and petroleum-based products, metals, and construction materials. Three broad industry categories were disproportionately affected by these increases: transportation, manufacturing, and construction. Six of the twelve District reports suggested that trucking firms were able to pass along most, if not all, of the cost increases to their customers. In contrast, Atlanta said that trucking firms were having a more difficult time increasing rates, and Chicago and Dallas indicated that competitive pressures were preventing airlines from passing along higher jet fuel costs. Manufacturers said that prices remained elevated for some other inputs, such as metals and plastics. While some Districts said that manufacturing firms had little success in passing along higher materials costs, one-third noted that more of their producers' customers were accepting price increases. Prices continued to rise for building materials in short supply, such as metals, concrete, and lumber. Here again, many builders had to absorb the higher input costs, but builders in the Cleveland and Kansas City Districts were able to pass along at least some of these increases to homebuyers.

Despite mounting cost pressures, most District reports suggested that retail price increases were still largely subdued. Boston was the only District to indicate that retailers were able to raise prices to the consumer in response to higher costs.

Agriculture/natural resources

Fall harvests were ahead of the normal pace in much of the country, as growing conditions improved in September and early October. Corn and soybean yields were expected to set records in some Districts. With lower current prices for corn and soybeans, more producers planned to store crops in hope of higher prices in the future. There were reports of storage and transportation constraints for corn. A record cotton harvest was expected in Texas, but both cotton and citrus crops in the Southeast experienced significant damage as a result of the hurricanes. Demand for livestock remained strong. Moreover, Kansas City and Dallas reported that pasture conditions had improved, and ranchers in the Dallas District suggested these conditions were "conducive for herd expansion."

Activity in the energy industry continued to increase, despite some disruptions in the Gulf of Mexico resulting from Hurricane Ivan. Minneapolis, Kansas City, and, to a lesser extent, Dallas reported increased drilling for oil and natural gas.

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First District--Boston

Economic activity continues to expand in the First District. Most retailers and manufacturers say third-quarter sales exceeded year-earlier levels. Hiring and capital spending remain cautious, and high energy costs are a source of concern. Contacts in the insurance industry report modest demand growth. Housing markets remain strong, although some homes are remaining on the market longer.

Retail

Most First District retailers report that sales in the third quarter were above year-earlier levels, ranging from flat to 7 percent gains. Demand is strong for lumber and lumber-related products, as home building and remodeling continue. Sales of women's apparel, jewelry, and accessories are said to be up, while men's apparel and home décor are down. An automobile dealers' group indicates that sales increased modestly in the third quarter compared to the previous quarter; manufacturers' discounts continue to be popular, and sales of services and parts keep dealerships' profitability afloat.

Travel and tourism revenues in the Boston area were reportedly strong in the third quarter. Hotel occupancy levels and room rates were up 15 percent compared to the previous quarter, almost reaching 1999 levels. Compared to last year, corporate spending on meetings and training has increased. Forward bookings through the remainder of the year are above year-ago levels, particularly for corporate holiday receptions and special events in December.

Some retailers note that inventory levels are slightly higher than planned. Contacts report some increases in vendor prices, mostly a result of rising transportation costs and price pressure on some commodities and petroleum-based products. Most of these increases are being passed along to the customers. Employment is said to be up in the third quarter, with some sizable increases, and wages are stable. Several contacts report that capital spending is currently below budgeted amounts, mostly because of under-spending on expansion projects.

Respondents say they feel the economy is solid overall, or at least holding steady, and many expect single-digit gains in the fourth quarter. Most contacts are worried about rising gas prices, while several express concern about soaring health care costs.

Manufacturing and Related Services

Most First District contacts in manufacturing and related services report that sales and orders in the third quarter of 2004 were slightly to well above year-earlier levels. Makers of pharmaceuticals and biotech, medical, and energy equipment report particularly large gains. Firms manufacturing office and IT equipment indicate that their business continues to grow, but at least some segments of their customer base are being cautious in placing orders.

Some makers of consumer products or items used in the manufacture of consumer products indicate that demand is sluggish. For example, a home appliance manufacturer reports that orders are relatively weak and a supplier of parts and equipment to the semiconductor industry notes a significant softening in that industry since its second quarter peak. Some respondents conjecture that increases in fuel costs are causing consumers to cut back on other purchases. Another mentions competition from foreign producers.

Companies that use significant quantities of petrochemical products indicate that some of their customers are now willing to accept price increases attributable to the sharply higher costs for these inputs. Nevertheless, these firms express concerns about downward pressures on their margins. Respondents acknowledge paying more for electricity and natural gas, but the impact on their overall costs tends to be muted because their operations are not very energy-intensive.

Most manufacturers are holding their U.S. headcounts fairly flat. Those with rapid growth are adding cautiously, while others are shedding positions as they adopt labor-saving technologies. Companies cite challenges in filling high-end positions that they attribute to heavy competition among employers in technology meccas such as Boston or to federal government security procedures. Pay increases, currently running in the 3 percent to 4 percent range, are expected to be little changed in 2005. Manufacturers generally expect their domestic capital expenditures to rise modestly in the coming year.

For the most part, contacts expect a continuation of current revenue growth patterns in 2005. Some express concerns about industry-specific developments or rising costs for energy and materials.

Residential Real Estate

Residential real estate markets throughout New England remain strong as contacts report high levels of activity in the third quarter. Following a long period of fast sales, when many homes sold within a few days, houses now remain on the market longer. Houses in lower price ranges continue to sell quickly according to brokers, while the highest-priced homes take especially long to sell. Consequently, the inventory of high-priced homes has increased, although the overall level of inventory in most areas has not changed markedly. Most respondents characterize local markets as still favoring sellers.

In most states, the number of sales has been higher in 2004 than in the same period of 2003. Prices remain robust, and most areas have experienced increases in sale prices this year. In Massachusetts, contacts say the average sale price for single-family homes in August was 12.5 percent higher than a year ago, while the average sale price of condominiums was up 4 percent. Other states report similar price increases. Most contacts anticipate that markets will remain stable in the next few months as long as interest rates stay low, although the typical winter slowdown in activity is expected.

Insurance

Respondents say sales of life insurance, particularly to individuals, grew slowly in the third quarter and in early October. Demand for variable annuities was notably stronger than for fixed income annuities and mutual funds. Disability insurance showed moderate demand growth over the same period, coupled with a further decline in disability claims; contacts suggest the decline in claims indicates the employment situation is picking up. Amid intense competition, some companies have focused on adjusting prices and restraining spending rather than seeking sales growth. Capital spending and employment levels are largely flat.

Respondents are mildly optimistic, expecting revenues to grow moderately over the remainder of 2004 and into 2005. While confident of the overall health of the economy, they express concern over such issues as rising energy prices and fiscal policy.

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Second District--New York

Economic growth in the Second District has shown further signs of cooling off since the last report. Retailers report that sales were below plan in September, though a few chains registered some improvement in early October. Recent business surveys suggest moderate deceleration in manufacturing-sector activity and further increases in input costs but little change in selling prices. New York City hotels and theaters report that tourism, though still relatively strong, has softened noticeably in recent weeks. Bankers report weakening in commercial loan demand, some tightening of credit standards and steady to lower delinquency rates.

On the positive side, the labor market has improved modestly--hiring of office workers is reported to be steady and there seem to be fewer applicants for open positions. The housing sector remains fairly robust, as reflected in a persistently strong market for existing homes and brisk construction activity. Finally, office markets in and around New York City showed mixed results at the end of the third quarter.

Consumer Spending

Retail sales continued to run below plan in September but moved closer to plan in early October. On a year-over-year basis, same-store sales over this period ranged from a 4 percent decline to a 4 percent gain. A number of contacts express concern about rising energy costs constraining consumers' discretionary income. Although a couple of contacts indicate excess stocks of certain merchandise, most say that inventories are at favorable levels. While retailers report that labor costs, merchandise costs and selling prices are all relatively flat, a few indicate declining merchandise costs on orders for next year. Virtually all retailers report continued steep escalation of energy and health insurance costs but note that other insurance costs have receded.

Consumer confidence improved in September, according to two separate surveys. Based on Siena College's survey of New York State residents, confidence rebounded sharply in the New York City area, reversing a decline in August, while confidence in upstate New York was little changed. Similarly, the Conference Board's survey of Middle Atlantic state (NY, NJ, PA) residents shows confidence rebounding to a two-year high in September, after slipping in August.

Construction and Real Estate

The housing sector has shown further signs of strength since the last report. New Jersey homebuilders report that the market for new homes has been robust, with traffic persistently brisk since Labor Day, and selling prices continue to run well ahead of comparable 2003 levels. Heavy rainfall has not significantly disrupted building activity, though production continues to be restrained by a dearth of developable land. Contacts report somewhat tight supplies of plywood and gypsum, reportedly due to diversions to the Southeast for rebuilding, but this has not caused any significant disruptions.

The market for existing homes in New York State continued to show strength in the third quarter--Realtors report that selling prices remained more than 15 percent ahead of a year ago, and the number of homes sold was up roughly 6 percent. Similarly, in Manhattan's co-op and condo market, selling prices per square foot were up 4 percent to 5 percent from the second quarter and up 15 percent from a year earlier; the volume of transactions was up marginally, though contacts report that this is partly a function of a low inventory of homes on the market. Manhattan's rental market has been generally stable since the last report: one contact reports that, following a dip in the second half of September, leasing activity has picked up again in October--particularly at the high end--though rents remain flat.

Office markets in the New York City area were again mixed in the third quarter. Manhattan's office market was little changed overall, as continued gradual improvement in Midtown Manhattan offset an upturn in vacancies in Lower Manhattan. Outside New York City, conditions were also mixed: Long Island's vacancy rate declined for the fourth consecutive quarter, falling to a three-year low, but northern New Jersey's vacancy rate climbed to 18 percent, the highest level in nearly a decade. Rates were virtually unchanged in New York City's northern suburbs--Fairfield and Westchester Counties.

Other Business Activity

A major New York City employment agency reports the market for office workers was improving gradually in September and early October; there are fewer people seeking positions, and hiring remains steady, led by the financial and legal industries. A contact in the financial sector reports that Wall Street bonuses, mostly paid out during the winter months, are expected to be up 8 percent this year, following a 17 percent increase last year. Associated with this cooling off, securities firms are being adversely affected by declining trading volume, declining margins, reduced market volatility, and reduced corporate bond issuance--all of which are expected to have a negative effect on industry employment over the next year.

Our latest monthly survey of New York State manufacturers, conducted in early October, indicates some deceleration in manufacturing sector activity but continued optimism about the six-month outlook; respondents also reported ongoing widespread cost pressures, but little change in selling prices. This is consistent with comments from a variety of businesses that note an inability to pass along rising costs to their customers. Purchasing managers in the Buffalo area also report deceleration in both new orders and production activity, but those in the New York area indicate steady improvement in business conditions. In both areas, respondents note that upward price pressures remain fairly widespread. Separately, a contact at a major shipping terminal reports that in-bound container volume has continued to strengthen, due to a combination of growing imports and ongoing diversion of shipments from West Coast to East Coast ports.

Tourism, though still fairly robust, has softened noticeably since the last report. Manhattan hotels report that occupancy rates retreated significantly in August--after adjusting for seasonal variation--and rose only marginally in September. Total revenues were up 15 percent to 20 percent from a year ago in the last two months, but this compares to increases of well over 20 percent in the spring and early summer. Similarly, Broadway theaters report that, after running moderately above a year earlier in the first half of September, both attendance and revenues weakened sharply in the following four weeks: attendance fell 7 percent from comparable 2003 levels, and revenues were down 9 percent.

Financial Developments

Small- to medium-sized banks in the district report reduced demand for loans in the latest survey, conducted in mid-October. Bankers report little change in demand for consumer loans but moderate declines in demand for commercial loans and mortgages and a continued decline in home mortgages--again reflecting a widespread decline in refinancing activity. Bankers report some tightening of credit standards, particularly on commercial and industrial loans. Interest rates on both loans and deposits increased across the board. Finally, bankers indicate declining delinquencies in several loan categories, most notably for residential mortgages.

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Third District--Philadelphia

Economic activity in the Third District increased in October. Manufacturers reported a rise in the number of orders and shipments compared with September. Retailers indicated that sales of general merchandise were up from the previous month and year; however, auto sales slowed in October following a strong showing in September. Banks have had gains in overall lending. There has been modest improvement among service sector firms. Employment agencies reported steady hiring by their client companies.

The outlook in the Third District business community is generally positive. Manufacturers expect increases in shipments and orders during the next six months. Most retailers anticipate steady improvement in sales or a slight pickup in the growth rate. However, auto dealers forecast a steady sales rate, at best, for the balance of the year. Bankers expect growth in total lending to continue, although they anticipate a slowing in residential mortgage activity. Service sector companies expect further improvement in the months ahead and possibly a quickening in the pace of growth.

Manufacturing

Manufacturing activity in the Third District rose in early October at about the same pace as in September. Nearly four out of 10 companies contacted for this report indicated that their rates of shipments and orders were up compared with the previous month, while around two out of 10 reported a decrease. Overall, order backlogs and delivery times at area plants were steady. Increases in new orders were relatively stronger for firms producing chemicals, petroleum products, and industrial materials and equipment. Producers of lumber products, furniture, and transportation equipment generally had slower order rates in early October than in September.

Around half of the manufacturing firms indicated that the prices of the goods they purchase rose from September, and around one third have raised the prices of the products they make. Many firms expressed concern about continuing increases in the costs of fuels, steel, and employee health insurance. Manufacturers have reported rising costs since the spring. In recent months the number of firms raising their own prices has increased.

The region's manufacturers expect further expansion in business activity. Almost half of the firms surveyed in early October expect increases in shipments and orders, and less than one in 10 expects decreases during the next six months. Area manufacturing firms are scheduling increases in capital spending and are planning to add employees in the next six months.

Retail

Retail sales of general merchandise in the Third District rose in early October compared to sales in September and in October of last year. Department stores and clothing stores had somewhat better results than other types of stores as the arrival of cooler weather prompted sales of fall apparel and other seasonal merchandise. The recent pace of sales has been roughly in line with most merchants' expectations. However, some women's clothing stores indicated they have not achieved the sales gains they had expected despite generally good sales of fall clothing styles.

Retailers expect modest improvement in sales in the final quarter of the year. Early forecasts of sales for the Christmas holiday shopping period are that the year-to-year gain will match or slightly exceed the annual sales increase posted so far this year.

Auto dealers reported a slowing in sales in October, following strong results in September. Dealers said the outlook for the rest of the year is uncertain, but several expect manufacturers to step up promotions in order to maintain sales rates close to the pace of recent months.

Finance

Outstanding loan volume at Third District banks was on the rise in October, according to banks contacted for this report. There have been gains in all major credit categories. Commercial and industrial loans grew modestly, as borrowing moved up among firms in a variety of industries. Bankers continued to report strong competition in business lending among bank and nonbank lenders, especially for intermediate term, fixed-rate loans. Residential mortgage lending has continued on an upward trend. Consumer credit has risen, with increases in credit card lending and some growth in home equity lending as well.

Bankers in the District generally expect loan growth to continue at about the current pace. They anticipate further gains in business lending, and some commercial bank lending officers believe growth in business lending could strengthen a bit. Bankers expect continued moderate growth in consumer lending, but they anticipate an eventual slowdown in residential mortgage activity.

Services

Most of the Third District service firms contacted for this report indicated modest improvement in business conditions in the past month. There has been some growth in information technology services. General business services activity has been on the rise, and the pace of growth has picked up somewhat. Trucking, rail, and ocean shipping companies have had growing activity, and some firms have raised prices as their costs for fuel and equipment have risen. Most of the service sector firms surveyed anticipate slightly better growth in business over the upcoming winter than they had during the summer.

Temporary and permanent employment agencies in the region reported moderate increases in demand for workers in the past few months, and they expect the pace of hiring to be steady for the balance of the year. Manufacturing and trade firms and educational institutions have relatively stronger hiring plans than do employers in other sectors.

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Fourth District--Cleveland

With some exceptions, growth in economic activity appeared to moderate in the Fourth District through the six weeks ending September. For most District manufacturers, production levels were steady in late August and September, while sales were weak for most retailers. Residential construction continued to slow as in recent reports, though nonresidential builders began to see signs of improvement. District banks reported rising loan demand among their commercial clients, and the transportation sector continued to see strong demand for its services.

Elevated input costs remained a persistent feature of the economic environment. In addition, plans for increases in hiring and capital spending continued to be isolated. Staffing services companies reported strong demand for workers with backgrounds in health care and engineering; however, demand from manufacturing firms for workers was weak.

Manufacturers

The District's durable goods manufacturers reported steady production through the six weeks ending September. Relative to the same time a year ago, production levels were higher for most firms. The outlook, however, has been somewhat diminished by domestic auto producers' announcements of production cuts. Some steel producers, among other auto industry suppliers, noted declining demand from automakers. Steel shipments in general, however, continued to be strong, despite some slowing from the pace of growth in the first half of 2004. Nondurable goods producers generally characterized production levels as flat for the last few weeks, but above the levels of this time last year. However, expectations for future activity have fallen somewhat.

More durable goods producers than in the past--about half--reported that they had higher inventory levels than desired. Durable goods producers generally planned to reduce capital spending through the next twelve months, and most planned to keep staffing levels stable in the near term. Few nondurable goods producers planned to hire soon. Rising input costs continued to confront both durable and nondurable goods manufacturers. The most prominent increases in input costs were for steel and petroleum-based products. However, it was reported that the available supply of steel is growing, and that steel price pressures may abate as a result.

Retail Sales

For the period from mid-August through September, District retailers generally reported sluggish sales. This conforms to the pattern of recent reports, which have depicted a sluggish retail sector since the late spring. Sales at discount stores were stronger than sales at department stores in the six weeks ending September, while sales at specialty stores were mixed by category.

Personal care products and accessories continued to sell well, while automobile sales were generally weak throughout the District in September. Apparel items also sold poorly in recent weeks. A few contacts noted that unexpectedly warm weather may have dampened demand for fall and winter apparel. Overall, contacts attributed the slowdown in spending at the District's retailers to uncertainty related to the upcoming presidential election and energy price changes. Nevertheless, some retailers reported improving sales in early October, while others were optimistic about the approaching holiday selling season.

Outside of energy and health-care costs, price pressures were generally muted at the retail and wholesale levels. For food-service firms and grocers, food prices reportedly stabilized recently, though some produce prices were affected by the recent rash of hurricanes. Regarding apparel retailers, a few indicated that they have increased markdowns in an attempt to reduce excess inventories. Generally, however, inventory levels were reported to be the same as or less than those from a year ago.

Construction

Residential construction continued to slow in the last several weeks. Sales also fell for most District homebuilders on a year-over-year basis. As in the previous report, this slowing sales pace was reflected across practically all price points. Customer traffic has also fallen since the summer. As a result, some builders have been reducing prices to spur demand. Residential builders also reported rising materials costs, for items such as steel, lumber, and concrete, as well as direct and indirect increases in costs from rising petroleum prices. These developments have reduced residential builders' profit margins.

By contrast, commercial builders began to see some improvement in business conditions in late August and September. While sales are still at low levels, the economic environment has improved in recent weeks, and sales for most firms are higher than at this time a year ago. Accordingly, contacts are cautiously optimistic about the future. Though it is reported that demand came from an array of sectors, a few contacts specifically cited increases in demand for industrial projects. The increases in materials costs cited by homebuilders also affected commercial builders, and many contacts reported that they cannot completely offset these increases in costs by raising their prices.

Banking

As in the most recent report, District banks continued to characterize consumer loan demand as steady to slightly increasing. However, despite declining mortgage rates in recent weeks, mortgage borrowing remained muted. By contrast, commercial loan demand--though still at low levels--seemed to strengthen through the last several weeks. Moreover, many banks reported that the number of their prospective loans to commercial clients also increased. Delinquencies reportedly remained at low levels. Finally, at most institutions in the District, deposit growth was flat.

Trucking and Shipping

Demand for trucking and shipping services continued to be strong throughout the District in August and September. Demand was so strong, in fact, that one contact reported turning business away because of a lack of personnel. While most firms attempted to augment their staffs, many found it difficult to attract and retain workers. Some firms reported recently increasing their wages as a result. Firms also reported increases in planned equipment purchases; an increase in the demand for new trucks has led to longer truck delivery times. Although contacts reported concern over rising petroleum prices, surcharges have allowed firms, in large part, to pass these price increases on to their consumers.

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Fifth District--Richmond

The Fifth District economy expanded at a quicker pace in September and the first half of October as the services sector rebounded from an August lull and manufacturing production gained further momentum. Revenues at services businesses picked up appreciably in recent weeks and retail sales increased in September for the first time in several months. Manufacturing shipments in September were notably higher and employment in the sector expanded modestly. While home sales were reported to be slowing in some areas, District real estate agents said that the demand for housing remained relatively strong. Prices surged for some raw materials used in manufacturing and construction, but contacts said that prices otherwise were rising only modestly. In agriculture, crop harvesting and small grain planting were generally ahead of schedule and pastures were in good to excellent condition.

Services

District services businesses said revenues strengthened in recent weeks. Government contractors in Virginia and West Virginia reported steady or rising revenues while a contact at a financial services firm in central North Carolina said he was seeing "improved sales." Several organizations reported increased hiring, including an environmental services firm in central Maryland and a community college in Virginia. There were scattered reports of higher prices: contacts at a Virginia airport and a central North Carolina freight services company, for example, said they raised prices to cover rising fuel costs, but overall price increases in the sector were generally modest.

Retail

Retail revenues improved somewhat during the last six weeks. Several grocery stores in

Virginia and West Virginia reported higher customer demand and the owner of a South Carolina building supply business told us revenues increased and that he had hired more employees. In contrast, a large building supply company in central North Carolina said sales slowed and automobile dealers reported mixed sales. Retail contacts said prices advanced more slowly in recent weeks.

Manufacturing

District manufacturing activity strengthened further since our last report as shipments expanded at a quicker pace and capacity utilization rose. A plastics manufacturer in North Carolina characterized business activity as "pretty good," noting that both shipments and new orders increased in September and contacts expected further increases over the next six months. A Maryland electronics equipment manufacturer reported that stronger product demand in the U.S. and in Mexico had boosted demand at his firm. Weakness persisted, however, in the textiles and apparel industries. Contacts in these industries generally reported sales declines and said they needed to trim their inventories as a result. District manufacturers reported a pickup in employment and modest wage growth in September. While several manufacturers were concerned about sharply higher prices for oil, steel, and aluminum, respondents generally reported that overall raw materials prices rose at a moderate pace.

Finance

District loan officers reported that loan demand was generally flat in September and early October. A banker in Charlotte, N.C., said that commercial loan demand improved, particularly from small- to medium-sized businesses, while a lender in Richmond, Va., noted a pickup in local and state government borrowing. But several industry contacts told us that businesses were reluctant to take on debt, with many waiting for sales to improve before borrowing. And a banker in Charleston, W.V., said that commercial lending was little changed in that area because the local economy remained "soft." Residential mortgage lending in the District was sluggish as well; mortgage originations for new homes held up in many areas, but refinancing activity dwindled.

Real Estate

Fifth District real estate agents continued to report a slowing in housing activity since our last report. An agent in Virginia Beach, Va., said his clients were simply not "moving as fast" to purchase homes. A contact in Richmond, Va., also reported slowness in home sales in recent weeks, as did an agent in Odenton, Md., who noted that the market seemed to be "returning to normal" after the frenzied pace earlier in the year. In contrast, home sales held their own in Fredericksburg and Vienna, Va., where markets were described as "outstanding" and "as strong as ever." Home prices continued to rise in Northern Virginia and in Washington, D.C., but were reported to be stable in most other areas of the Fifth District.

Realtors reported little change in Fifth District commercial leasing activity during the last six weeks. A contact in Richmond, Va., noted "We are seeing some musical chairs," as existing tenants move from building to building, but "there hasn't been any substantial recent growth in terms of new clients." Office and industrial leasing was stagnant in most areas in recent weeks. Retail leasing, which has been the strongest commercial market sector this year, remained stalwart in September and October, although contacts in Raleigh, N.C., Richmond, Va., and Washington, D.C., cautioned that a slowdown could be imminent. "Retail has really been booming for the last couple of years, but that success may have led to substantial overbuilding of retail space," observed a Realtor in Raleigh, N.C. Rents and vacancy rates across sectors were generally unchanged in recent weeks.

Tourism

District tourist activity strengthened since our last report. Contacts in both coastal and mountain areas reported increased bookings compared to a year ago. A hotelier in Virginia Beach, Va., told us that they were at capacity during Columbus Day weekend. A contact in Myrtle Beach, S.C., said that tourism declined in August because of hurricanes and storms, but business picked up in September and group bookings were strong. A manager at a mountain resort in Virginia noted that they were "packed" over the holiday which he attributed to beautiful fall weather.

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 warehouse and distribution center workers. And an agent in Raleigh, N.C., expected a pickup in demand for temporary workers over the next few months because there were fewer qualified job candidates to fill permanent positions and firms seemed to have more funds available to hire temporary employees.

Agriculture

Cooler temperatures coupled with drier conditions allowed Fifth District farmers to make steady progress in small grain plantings and harvesting activities. Farmers in Virginia, West Virginia, and the Carolinas moved quickly to plant small grains and winter crops during the rain-free period. Although corn harvesting in Virginia has been somewhat delayed due to a lack of space at storage facilities, corn harvesting activity in other areas of the District was generally ahead of schedule. In addition, pastures and livestock were reported to be in good to excellent condition in most areas of the District.

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Sixth District--Atlanta

Business contacts indicated that economic activity in the Sixth District moderated during September and early October, in part because of hurricane-related disruptions. Although merchants' sales were mixed during September because of the storms, most contacts reported that fourth-quarter retail sales are expected to exceed those of a year ago. The weather also affected residential and commercial building activity, slowing sales and creating material and labor shortages mainly in Florida. The hurricanes temporarily interrupted factory production in some areas. Contacts also indicated disruptions to the tourism and hospitality industry, and some uncertainty about the pace of recovery in these industries. Labor market reports noted strong demand for laborers and specialized construction workers. Prices remained elevated for building materials and energy. Farm output was adversely affected by the storms.

Consumer Spending

District retail contacts reported that sales results varied during September compared with last year. Some Florida merchants reported that hurricanes closed stores for as many as five days, while a middle-Georgia retailer noted that traffic was light during the first two weeks of September. Some stores benefited as evacuees moved north out of the paths of the storms, and demand at building supply stores was very brisk. Improvements were noted in most parts of the region during early October. However, auto sales in the District continued to disappoint.

Real Estate

Construction was hampered by severe weather in September, and contacts reported that rebuilding to both commercial and residential properties is expected to cause temporary labor and material supply shortages as resources flow into storm-damaged areas. Florida's housing market was particularly affected as both construction work and sales came to a standstill for several days. Outside of storm-affected areas, there were fewer disruptions, with construction and new home sales near year-ago levels and existing home sales down modestly from last year.

Manufacturing

Reports from the factory sector for September were mixed. Contacts suggest that some manufacturing firms temporarily ceased production during the storms because of lost power and/or facilities damage, and several smaller manufacturers were forced to close because some staff were away making repairs on their homes. In addition, supply disruptions appeared to be a problem for those relying on just-in-time inventory management. Gulf oil and gas fields, as well as several refineries, lost production as a result of the storms. Building supply firms noted increasing orders and high operating rates. Outside of the storm-affected areas manufacturing was generally steady.

Transportation

Trucking contacts continued to report strong demand for transportation services. Several reports noted that it was more difficult to pass on higher fuel costs to customers. Companies involved in delivering construction materials to storm-affected areas in Florida reported robust business.

Tourism and Business Travel

The District's tourism and hospitality industry took a substantial hit because of the hurricanes. For instance, the cruise industry, with five homeports in Florida, reported financial losses because of temporary port closings. Several Florida resorts and motels announced layoffs and closures until damage is repaired. However, major central Florida theme parks suffered little damage and were able to quickly restore operations. Damage to coastal rental properties in Florida and Alabama is expected to slow visitor traffic until repairs are completed. Offsetting this somewhat, hotels near the damaged areas reported high demand from insurance, utility, and government relief workers.

Financial

Responses from the financial sector were mostly upbeat. Most respondents in storm-damaged areas anticipate growth in deposits as damage claims from the hurricanes are processed. Requests for loans in some affected areas have reportedly increased substantially. In other parts of the District banking activity was described as robust. Contacts noted that the mortgage market was holding up well; refinancing had decelerated but was still at strong levels.

Employment and Prices

Labor markets were mixed. The hurricanes forced temporary layoffs at some Florida hotels and resorts. Contacts also noted a surge in restaurant closings because of lost revenues because of the storms. Construction labor was said to be migrating to storm affected areas to take advantage of variable wages, and that this was placing stress on construction projects in other areas. Outside of construction, manufacturing contacts noted an increase in overtime in recent weeks as plants attempted to make up for lost production during the storms.

Prices for building supplies continued to rise in the region, fueled by hurricane-related demand. Industry contacts predicted that drywall and roofing shortages would lead to even higher prices during October. Elevated prices for steel, concrete, and plywood have kept building costs at a high level throughout the District.

Agriculture

Hurricanes affected farm production in Alabama, Florida and Georgia. Damage to Florida farms was estimated to be near $3 billion. The USDA reported that Florida orange production levels were down 27 percent from last year's harvest and the grapefruit crop was down 63 percent. According to some estimates, lost cotton production in the region could amount to over $200 million. Industry contacts expect only a moderate impact on prices of orange juice and cotton products because of strong global supply conditions.

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Seventh District--Chicago

The Seventh District economy continued to expand at a moderate pace in September and early October. Consumer spending remained relatively soft, while business spending continued to firm. Overall construction and real estate activity again was robust, although some further slowing was apparent on the residential side. Manufacturing expanded solidly. Loan demand from households eased since our last report, while business loan demand picked up. Input costs remained high and wages were trending up, but retail price increases were largely constrained by fierce competition. Crop conditions have improved since our last report, and the District's corn and soybean harvests could set records.

Consumer spending

Contact reports again were mixed, but on balance suggested that consumer spending remained somewhat soft in September and early October. Retailers generally indicated that recent sales results came in at the low end of their expectations, if not below. Once again, national chains suggested that the Midwest was one of the weaker performing regions. Some contacts blamed unseasonably warm weather for slow sales of fall and winter apparel, although most expected these sales to be recouped when temperatures cool. Retail inventories were reportedly in good shape heading into the holidays. District auto dealers indicated that light vehicle sales fell off in early October, after surging toward the end of September. Strong September sales helped bring excessive inventories down to more desirable levels for many dealers. Most were cautiously optimistic about sales for the remainder of the year, and were ordering light vehicles accordingly. Tourism and related spending were largely unchanged since our last report, at levels slightly above those of a year-ago. Many contacts said that high oil prices and uncertainty surrounding national elections may be lowering consumers' confidence and delaying purchases.

Business spending

Business spending rose again in the latest reporting period, with more firms noting increases in capital spending. Some contacts said that special factors, such as changing environmental regulations and expiring tax incentives, contributed to higher capital outlays. Trucking and rail companies continued to boost capital spending as freight volumes trended even higher. Airline contacts noted that bookings for business travel remained strong, particularly on international routes. A printing company contact said that orders from advertisers had risen somewhat over the past few months. With regard to hiring, one large temporary help firm indicated that year-over-year growth in billable hours had fallen considerably in September, but appeared to be rising in early October. Much of the weakness in September was in lower-skilled positions; demand for professional and technical workers remained very strong. Several temp help contacts said that permanent placements continued to rise. More manufacturers indicated that they had recently hired, or planned to hire, additional workers in response to strong demand for their products. Outside of manufacturing, there were scattered reports of permanent hiring. Although outright worker shortages remained few, several contacts said that they were receiving fewer applications for open positions.

Construction/real estate

Overall construction and real estate activity remained robust. Realtors and builders continued to portray the housing market as solid. However, several noted that residential activity appeared to slow more than they had expected. A Realtor in one large market said that September's sales had come in below year-earlier levels for the third straight month, something that hasn't happened in a long time. Moreover, the number of homes listed for sale had been moving lower as well. While most contacts maintained a bullish outlook for home sales, they had become more concerned by the recent slowing trend. On the nonresidential side, office leasing activity seemed to pick up in recent weeks. One contact said that net absorption of office space in some areas turned positive after an extended period of being negative. However, vacancy rates may remain elevated as new space is expected to come into the market in coming quarters. Retail development and leasing activities were again robust. By contrast, contacts noted some slight softening in the light industrial segment.

Manufacturing

Manufacturing activity expanded solidly, and strength was widespread across many of the District's key industry segments. Production and orders were strong, and some contacts noted more "forward-looking orders" that, if sustained, could lead customers to expand their production capabilities. One producer of machine tools was particular pleased with the "depth of buying," noting that the firm was getting orders from customers it had not seen in two or three years. Production, shipments and orders for heavy equipment (agricultural, construction, mining) remained strong. This activity, and other factors, continued to boost the demand for steel. Contacts were expecting steel prices to remain high in coming months, so some users, such as steel service centers, were no longer delaying steel purchases in anticipation of lower prices. Meanwhile, steel mills could not boost production fast enough to keep up with demand. One producer of home appliances also noted that continued strong demand was making it difficult to build inventories. Nationwide, light vehicle sales picked up markedly in September, which helped bring bloated inventories down to more manageable levels for some makes and models. More generally, manufacturing contacts suggested that domestic producers were benefiting from a relatively weaker dollar and higher shipping costs, both of which have increased the costs of imported goods.

Banking/finance

In a reversal of recent trends, lenders reported some softening in household loan activity, but a modest pickup in business lending. Nearly all of our banking contacts reported a slowdown in residential mortgage loan applications, for both purchases and refinancing. Reports on the demand for other types of household loans (home equity, credit card, etc.) varied. Standards and terms on household loans were largely unchanged and credit quality continued to improve. A few bankers reported a long-awaited, albeit modest, increase in business lending activity. One contact said that business loan volumes had increased in September, after several months of virtually no growth. Still, the increase in business loan volumes fell short of the bank's plans. Another contact reported that borrowing for operating expenses picked up modestly, but demand for capital spending loans remained weak. All of the bankers contacted reported that competition for business loans remained intense. None of the banks contacted said they were relaxing covenants, although margins were being squeezed. Business credit quality continued to improve, allowing many lenders to reduce contributions to their loan-loss reserves.

Prices/costs

Input prices remained elevated and employment costs edged higher, but retail price pressures still were largely subdued. Persistently high steel prices have led more and more firms to accept surcharges on steel products. Higher energy costs continued to alter business plans. Freight haulers were able to pass along higher fuel prices amidst what one contact called "the best pricing environment" for the industry in the last 20 years. By contrast, airlines have been unable to raise air fares, and some said they will need to cut labor costs further to offset higher jet fuel costs. More generally, however, contacts suggested that wages were trending slightly higher in the latest reporting period. There were also scattered reports of firms paying hiring and retention bonuses, after several years of absence. One temporary help firm said that higher taxes for unemployment insurance, and already tight margins, will force the firm to raise prices in 2005. Despite cost pressures elsewhere, retail price increases were in large part subdued by fierce competition.

Agriculture

Crop conditions have improved since our last report, and the District's harvests of corn and soybeans could set records. Crop maturation was aided by warmer-than-typical temperatures in September. This allowed late-planted fields to catch up, especially in some northern portions of the District. Corn and soybean prices dipped again, although corn sold to ethanol producers garnered a price premium. Many farmers were leaving corn in the field longer to reduce moisture content and minimize drying costs at elevators, and many have decided to store their crops in the hope of higher prices later. Contacts in Illinois and Indiana said that rail and truck capacity constraints were pushing shipping costs higher and delaying crop shipments. With high crop yields, government payments, relatively low interest rates, and little land on the market, farmland values continued to rise.

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Eighth District--St. Louis

Reports on economic activity in the Eighth District were mixed in the period since our previous survey, particularly in the manufacturing sector. The number of manufacturing contacts reporting plans to open plants or expand operations was roughly equal to the number of contacts reporting plans to close plants and lay off workers. In contrast, contacts in the services sector generally reported strong activity. Retail and auto sales were flat to slightly down in August with respect to year-earlier levels. Residential real estate markets continued to do well. Total loans at a sample of small and mid-sized District banks increased from late June to late September.

Manufacturing and Other Business Activity

Reports from contacts in the manufacturing sector in the period since our previous survey were mixed. A number of manufacturers reported plant openings and expansions and a similar number of contacts reported plant closings and cutbacks. Firms in the nonmetallic minerals, automotive parts, and fabricated metal products industries announced plans to open new plants that would create 650 new jobs. Firms in the machinery, steel, freight transportation equipment, fabricated metal products, and plastics industries reported plans to expand existing plants, renovate production lines, add new space, and hire additional workers. In contrast, firms in the mining and natural resources, machinery, and nonmetallic minerals industries announced plans to close plants, displacing as many as 400 workers. Firms in the machinery, rubber products, computers and electronics, and automobile industries announced plans to consolidate and restructure their workforce, displacing about 500 workers.

In the services sector, most contacts reported an increase in activity since our previous survey. Firms in the software development and pharmaceutical research, development, and marketing industries reported plans to relocate their headquarters to the District, adding as many as 350 new jobs. In addition, firms in the military, freight transportation, and financial services industries reported facility openings and renovations that would create almost 900 new jobs. Despite reports of generally strong activity in the services sector, firms in the automotive maintenance and repair and health care industries are cutting back on their workforce. Many District auto dealers and general retailers reported flat to slightly down sales in August from the same month a year ago. Major department and discount chains, in particular, reported slow sales. Other retailers, including those in the home goods, furniture, and clothing industries reported plans to open new facilities.

Real Estate and Construction

Residential sales were up in most of the District in August. In Memphis, August year-to-date sales increased by 16.1 percent compared with the same period in 2003. The increase in August year-to-date sales was 4.7 percent for the greater St. Louis area and 12 percent for southern Indiana. Sales slowed down somewhat in north central Arkansas. Year-to-date single-family housing permits continued to increase in most of the District's metropolitan areas compared with the same period last year. August year-to-date permits in the greater St.

Louis area increased by 19.5 percent compared with the same period in 2003, while August year-to-date housing starts grew by 6.9 percent in the Tupelo region compared with the same period last year. Residential construction also increased in southern Indiana and northeast Arkansas, but it slowed down considerably in west Tennessee.

Activity in the District's office and industrial real estate markets has been mixed in recent months. The third quarter office and industrial vacancy rates in the St. Louis metropolitan area experienced little change compared with the previous quarter. The overall office vacancy rate rose by 10 basis points, while the overall industrial rate fell by 10 basis points. The office vacancy rate in Bentonville, Ark., increased by 5.3 percentage points to 19.6 percent during the first half of 2004. The pace of commercial construction continued to increase modestly in most of the Eighth District. Contacts in north central Arkansas reported a slight increase in construction, and construction activity was steady in southern Indiana.

Banking and Finance

Total loans outstanding at a sample of small and mid-sized District banks increased 2.2 percent from late June to late September. This increase stems from a 2.9 percent rise in real estate loans along with a modest 0.4 percent growth in commercial and industrial loans. Loans to individuals and loans to commercial banks continued to decline, dropping by 1.3 percent and 4.8 percent, respectively. Over the same period, total deposits at these banks rose 3.2 percent.

Agriculture and Natural Resources

Recent dry weather has allowed crop harvests to progress nicely. Nearly all corn has been harvested in the District states, except in Illinois, Indiana, and Missouri. The soybean harvest is well ahead of its average pace, and farmers have harvested over half of the entire soybean crop. Farmers in the District states expect higher yield and production of both corn and soybeans compared with last year. Farmers in Arkansas and Mississippi have nearly finished the sorghum harvest, and almost all of the District rice and about half of the cotton have been harvested. Winter wheat planting is under way but behind schedule in most District states. Missouri is the only District state where a majority of the soil moisture levels are rated as adequate or surplus, and Tennessee is the only District state with the majority of pastures rated in good or excellent condition.

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Ninth District--Minneapolis

From September through mid-October signs of economic growth were evident in the Ninth District. Growth was noted in commercial real estate, manufacturing, energy, agriculture, consumer spending and tourism. Conditions were steady in residential real estate and mixed in mining. District job growth and wage increases were modest. While overall price increases appear to have been moderate, significant increases were noted for manufacturing and construction materials, retail food, heating fuel and petroleum.

Construction and Real Estate

Commercial construction was solid. Contracts awarded for large construction projects in Minnesota and the Dakotas increased 6 percent for the three-month period ending in August compared with a year ago. A northern Wisconsin contractor recently noted activity was up 20 percent for the year. A Minneapolis-area real estate investment company reported strong investment and a positive outlook. In contrast, office markets in Minneapolis-St. Paul remained weak, with high vacancy rates and negative absorption, but analysts predict improvement in the next year as jobs grow.

Residential real estate was steady. In Minneapolis-St. Paul, new housing units authorized in September remained roughly flat from a year earlier. A Minneapolis-area realtor noted that residential markets are cooling, with slight price reductions and homes now sitting on the market an average of 50 days, up from 45 days recently and 25 to 30 days a year ago. In Eau Claire, Wis., developers are considering building a 700-unit condominium development.

Consumer Spending and Tourism

Overall consumer spending grew moderately. A Minneapolis-area mall manager observed level to slightly slower traffic in September compared with last year, followed by a pickup in early October. A North Dakota mall manager reported same-store sales up about 3 percent during September and early October, slower than the 6 percent growth pace for the year. A mall manager in Montana said traffic was up 1 percent during September compared with a year ago; sales of outer wear were slow, in part due to warm weather. A major Minneapolis-based retailer reported same-store sales up 5.6 percent in September compared with a year ago.

While overall car sales in North Dakota have been positive year to date, recent sales were spotty, according to a representative of an auto dealers association. In Minnesota an auto dealers association representative reported that customer traffic was slow at dealerships during September and early October.

Late summer and fall tourism was above year-ago levels. A tourism official in Montana reported good fall tourism conditions; people were spending more. After a slow summer overall, favorable weather has helped prop up fall tourism in the Upper Peninsula; crossings over the Mackinac Bridge were up 7 percent in September compared with a year earlier. In South Dakota, a member of the Advisory Council for Small Business and Labor reported that tourism business operators were generally pleased with late-summer activity, but noted that spending increases lagged gains in attendance at major destinations.

Manufacturing

Manufacturing activity increased. A September survey of purchasing managers by Creighton University (Omaha, Neb.) indicated overall improved manufacturing activity in the Dakotas and Minnesota. In Minnesota, a company that produces product labels plans to add a second shift due to a surge in orders over the last month. "The industrial economy is very good," said a contact from a large metal-services company in Minnesota. In the Upper Peninsula of Michigan, a plastic injection molding company indicated that sales volume was up 7 percent for the month of September compared with a year ago. In northwestern Wisconsin, a lumber mill plans to add two dry kilns, a diaper manufacturer plans to expand, but a mattress factory plans to shut down.

Energy and Mining

Activity in the energy sectors remained strong, and mining activity was mixed. Early-

October district oil production increased from early September. Increases in oil prices spurred companies to increase drilling activity in the district. Iron ore mines continued to produce at capacity, and investments to expand production are planned at two mines in northern Minnesota. The operating mines in Montana experienced some difficulties as the quality of ore at some mines decreased somewhat, and bottlenecks with new equipment hampered output. "It has been a tough month," a Montana mining official commented.

Agriculture

Agriculture was up. The U.S. Department of Agriculture forecast that the corn harvest will set new records in Minnesota and North Dakota, with near-record production in South Dakota. District soybean production is expected to be considerably higher than last year. The wheat harvest is anticipated to increase in Montana and slightly decrease in North Dakota. In South Dakota, production of dry beans and sunflowers is forecast to increase 35 percent and 36 percent, respectively.

However, the dry bean and sunflower harvests in Minnesota and North Dakota are expected to decrease significantly. The Minnesota sugar beet harvest is predicted to come in 5 percent below last year, with some farmers voicing concerns over the sugar content. Also, the forecast is more uncertain this year than in previous years; due to this year's cool summer, crop immaturity is causing harvesting delays.

Prices are mixed. The USDA forecast decreases in prices for corn and soybeans and an increase in wheat prices.

Employment, Wages and Prices

The number of net new jobs grew modestly. A representative of a Minneapolis-St. Paul employment service recently indicated that labor markets have tightened for a number of industries. Strong demand for upper-level finance-related jobs was noted by industry observers. In northwestern Montana, some local employers noted that finding people to fill job openings is becoming more of a challenge. Meanwhile, temporary and permanent placements were up, according to a recruiting and employment services company in Minneapolis-St. Paul. Initial claims for unemployment insurance dropped 18 percent in Minnesota during September compared with a year ago.

In contrast, a major Minnesota-based electronics manufacturer recently announced plans to lay off about 75 to 100 employees. A St. Paul-based software company said that it will reduce its workforce by about 50 jobs at its headquarters this fall. Also in Minnesota, workers at a pickup truck assembly plant were furloughed for five weeks beginning in October due to declining sales, and a food processing plant will lay off about 100 workers. A Montana telemarketing company recently closed, affecting 64 workers.

Wage increases were moderate. Manufacturing wages were up 2.8 percent in district states for the three-month period ending in August compared with a year ago.

Price increases were noted in manufacturing and construction materials, retail food, heating fuel and petroleum. Manufacturing and construction materials prices edged up, including aluminum, copper, diesel fuel, steel, lumber and lumber products. Retail food prices increased 4 percent in the third quarter, according to a survey by the American Farm Bureau Federation. Prices of natural gas for November delivery were up about 40 percent compared with a year ago. October prices for heating oil in Minnesota were up almost 45 percent from a year ago. Gasoline prices in Minnesota in the beginning of October were 20 percent higher than a year earlier.

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Tenth District--Kansas City

The Tenth District economy continued to expand in September and early October. Retailers posted steady gains, manufacturing activity increased, and labor markets showed further improvement. Energy activity was very strong, and the housing and agriculture sectors remained solid. On the negative side, commercial real estate was still weak. Wage pressures were generally modest, but some price pressures were evident at the wholesale level and for a few retail goods.

Consumer Spending

Consumer spending in the district continued to grow in September and early October. Most store and mall managers reported steady year-over-year sales gains following a pick-up in sales growth in the previous survey. Among product categories, home items and men's and children's clothing sold particularly well. Restaurant business was also generally reported as solid. A majority of stores increased inventories since the previous survey, and most store managers were satisfied with current inventory levels. Several managers noted that they planned greater inventory expansion for the holiday season than in recent years, and virtually all managers expect solid improvements in sales up to and including the holiday season. Motor vehicle sales in the district were basically flat compared with previous months and slightly lower than a year ago. Nearly all dealers anticipate stronger sales heading forward, and most dealers were satisfied with current inventory levels. Travel and tourism activity in the district was mixed in September and early October. Hotel occupancies eased somewhat, but airport traffic picked up across the district after falling slightly in the previous survey.

Manufacturing

District manufacturing activity continued to expand solidly in September and early October. Manufacturers reported that production, shipments, and orders all increased from the previous survey. A large number of firms added employees and increased capital spending, while only a small number of firms reported cutbacks in these areas. Most aircraft manufacturing contacts noted recent improvement, and several contacts in the steel and food industries reported they were operating close to full capacity. Material availability problems were reported by a sizable number of firms, especially users of petroleum-based products and aluminum. Optimism about future production remained high. Many firms plan increases in employment and capital spending in coming months, while only a few plan reductions.

Real Estate and Construction

Housing activity generally remained solid in September and early October, while commercial real estate was still weak. Single-family housing starts were largely flat compared with mid-summer and with a year ago but were still high by historical standards. Several builders, however, reported a weakening in construction of high-end homes. Most builders expect home starts to slow slightly in the months ahead but to generally remain solid. Building materials other than cement were typically easy to obtain, and builders expect few difficulties obtaining materials heading forward. According to realtors, home sales in most parts of the district eased slightly from recent months and were also down modestly from a year ago. Similarly, mortgage lenders reported a slowdown in mortgage demand, and most realtors and mortgage lenders expect some continued easing in home sales in coming months. Commercial real estate activity in the district was still weak, but contacts were somewhat more upbeat about future activity than in previous surveys. Vacancy and absorption rates remained flat in most cities, while sales and leasing activity increased moderately. Over the next six months, about half of the commercial realtors contacted expect some improvement in vacancy and absorption rates.

Banking

Bankers report that both loans and deposits increased slightly since the last survey, leaving loan-deposit ratios little changed. Demand edged up for commercial and industrial loans, residential construction loans, and commercial real estate loans, while demand eased somewhat for home mortgages. On the deposit side, all types of accounts edged up except large CDs, which were flat. All respondent banks raised their prime lending rates since the last survey, and all banks either raised their consumer lending rates or planned to do so in the near future. Lending standards were generally unchanged.

Energy

District energy activity remained very strong in September and early October. The count of active oil and gas drilling rigs in the region continued to edge higher and was up considerably from a year ago. Some producers continued to report constraints on drilling due to labor, material, and equipment shortages, though a majority of firms said they were drilling at their desired level. Expectations for future drilling activity were mixed. Several contacts said permit restrictions will reduce drilling over the winter, and others indicated some caution due to uncertainty about the future price of oil. On the other hand, a number of contacts anticipate further modest expansion due to their expectations for continued high oil and gas prices.

Agriculture

Agricultural conditions in the district generally remained solid in September and early October. With the harvest of spring-planted crops about half complete, crop quality and yields were generally at or above average levels. Also, fewer crop producers than in past years expected to file crop insurance claims. High yields, however, put downward pressure on prices, and some producers reported plans to store crops in anticipation of higher prices in the future. In the livestock market, high cattle prices continued to limit herd expansion, though pasture conditions improved over last year due to abundant moisture. Bankers generally expect farm incomes to increase slightly from last year's levels.

Wages and Prices

Wage pressures generally remained modest in September and early October, but some price pressures were evident at the wholesale level and for a few retail goods. Labor markets continued to show improvement, as hiring announcements rose further and layoff announcements declined. With the exception of oil and gas field workers and some types of skilled manufacturing workers, firms generally had few difficulties finding qualified workers, and most firms outside of the energy sector continued to face few wage pressures. Within the energy drilling sector, however, contacts reported raising wages 10 percent or more to attract entry-level field personnel. Most retailers reported flat selling prices compared with previous surveys and expect little change in prices heading forward. Exceptions include sellers of furniture, flooring, appliances, and hardware, who have raised prices slightly and expect further increases in coming months due to higher wholesale prices. Builders reported increased prices for a broad range of materials--including lumber, drywall, and a number of oil-based materials--and said they were passing these increases through to their customers. Some builders expect the materials price pressures to ease in coming months, but others do not. As in previous surveys, a large number of manufacturers reported increases in materials costs, and many of these firms also reported increases in output prices. Also, a sizable number of manufacturers expect to raise their output prices further in the months ahead. In addition, several trucking firms noted sharp increases in diesel fuel prices. These firms reported raising rates as much as possible to cover the increased costs but said they were limited in some cases by long-term contracts.

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Eleventh District--Dallas

Eleventh District economic activity appears to have picked up slightly from late August to mid-October. Manufacturing activity strengthened some, and business services activity continued to expand at a moderate pace. Retail sales increased at a slightly slower pace than earlier in the year. Construction and real estate activity remained mixed. Bankers report continued increases in lending but weak deposit growth. The energy industry describes activity as very healthy but less than might be expected on the basis of current energy prices. The Texas cotton harvest in expected to be the largest in the state's history, about one million bales higher than the record 1949 harvest.

High energy prices and, to a much lesser extent, uncertainty about global terrorism and the pending presidential election have contributed to continued hesitation in hiring and investment, according to respondents. Still, most contacts have a very favorable outlook for activity and believe that the current expansion will continue to slowly improve.

Prices

There are more reports of price increases than in mid-August, particularly for energy. There are some reports of higher energy costs pushing up selling prices, but most contacts say stiff competition is causing these higher expenses to drain profits rather than boost selling prices.

A number of factors, including hurricane Ivan, low inventories and increased demand, helped push oil prices above $50 per barrel in October. Gasoline and heating oil prices rose along with the price of crude oil and were pushed up more after hurricanes shut down refinery capacity in Louisiana. Demand for gasoline was moderate, and inventories dropped below the five-year average. Heating oil and distillate inventories dropped sharply, and the price of heating oil and diesel rose to record levels (in nominal dollars). Natural gas prices also rose sharply, even though winter storage of natural gas is in good shape and headed for a possible record before the heating season officially begins on November 1.

Boosted by rising feedstock prices, prices have been rising for basic chemicals such as ethylene, as well as for a variety of intermediates and plastics such as polyethylene, polypropylene, PET bottle resin, polystyrene, and PVC. Primary metal producers say most input prices are still rising due to continuing growth of demand in China. Agricultural producers say high fuel prices are raising costs of fertilizers, chemicals, farm machinery operation and field irrigation.

Labor Market

There has been little change in the labor market. Most contacts indicate no wage pressures. There were very few reports of lay offs, but most companies also have no plans to increase hiring in the near term. Contacts are relentless in their concern about high benefit costs, particularly for health insurance.

There are a few areas of tightness in the labor market. Accounting firms report that there is a bidding war for workers to support audit activities, with firms bringing skilled professionals from United Kingdom, Canada and India. Trucking firms report a persistent shortage of qualified drivers.

Manufacturing

Overall manufacturing activity appears to have strengthened some. Sales have been dampened as a result of hurricanes in Florida and the Gulf of Mexico. The Chinese economy remains a focus for some producers, both as a consumer and a competitor.

High-tech manufacturers report stable to slightly stronger growth in orders. Increased demand for consumer products such as MP3 players, video game systems and personal computers prompted a pickup in orders for semiconductors. Contacts say semiconductor inventories remain lean, even though technological improvements have increased capacity. Some respondents say that prices, which had been falling, have begun to flatten out over the past 30 days.

Demand for most paper products increased more than is typical for this time of year. Only producers of corrugated boxes reported weak sales that they attribute to customer resistance to an increase in selling prices caused by higher energy costs. Food producers say demand has picked up over the last several months. Demand for apparel products has been stable over the last 30 days, which is slightly higher than three months ago and up from a year ago.

Construction-related manufacturers, such as lumber, reported strong and steady demand, up from a year ago. The hurricanes caused some softening in demand for glass because clean up is delaying new construction. Demand for primary metals is up slightly, but there is concern that a slowdown in the Chinese economy will reduce demand for domestic metals that U.S. producers sell to China. Demand for fabricated metals has been high, but contacts say their inventory levels are also higher than normal.

Demand for petrochemicals is very strong, bouncing back from weakness in August and September. Producers say foreign demand has increased because oil prices have risen faster than natural gas prices, making U.S. chemicals, which are natural gas-based, more competitive than oil-based foreign production. Demand has been strong enough to allow producers to increase selling prices to cover higher costs and higher profit margins.

District refiners have operated at very high levels, partly in response to hurricane-related disruptions at other refineries. Falling inventories pushed up selling prices and profits. Hurricane Ivan reduced oil production capacity in the Gulf of Mexico by nearly 30 percent through mid-October and created a shortage of sweet crude used by most Gulf Coast refiners.

Services

Business services activity continues to expand at a moderate pace. Temporary staffing firms say activity is slightly stronger than a year ago. Demand is still strongest to supply workers for non-durable manufacturing. There have been few orders for workers to supply call centers, financial services or durable goods manufacturing. There were scattered reports of layoffs, and one contact noted that fewer workers have been promoted from temporary to permanent positions.

Accounting firms report continued strong demand, mostly due to increased audit and assurance services necessary to fulfill Sarbanes-Oxley requirements. Contacts say that firms have increased their workforce by as much as 25 to 35 percent to support audit work but hiring to support the tax side of the business has been soft. Law firms report that demand is unchanged or up slightly over the past 6 weeks, which is slightly weaker than earlier in the year.

High fuel costs are a major concern for transportation service firms. Only one airline said they were sufficiently hedged against higher fuel costs. With excess capacity and intense competition, few airlines expect to make a profit. The trucking industry says the business outlook remains strong, but they are concerned about the possibility of even higher high fuel costs. Railroads continue to see increased activity--hiring remains strong and investments in new technologies continue to help the industry expand capacity and streamline operations.

Retail Sales

Retail sales continue to grow but at a slightly softer pace than earlier in the year. Contacts say that high energy costs are taking a bite out of consumer's wallets and the simulative effects of tax cuts and low interest rates have waned. Still, contacts are optimistic about sales growth over the holidays, noting that consumer credit is in good shape. Automobile sales continue to decline and remain below last year's levels, especially among less fuel-efficient vehicles.

Construction and Real Estate

Homebuilding remains strong, although some contacts noted softer demand for mid-priced homes. Inventories are edging up for some builders, and incentives are increasing. Demand for existing homes has softened following three quarters of strong sales, causing inventories to inch up. Apartment markets continue to be burdened by an oversupply of units.

Office markets improved over the past six weeks, continuing their slow recovery. Contacts say demand for office space in Austin is picking up and Dallas recorded positive absorption for the first time in four years. Commercial construction continues to be driven mostly by public projects. Construction of health care facilities remains especially strong.

Financial Services

Bankers report little change in conditions with continued increases in lending and weak deposit growth. Commercial and industrial loan volume and traffic is up. Mortgage lending is flat or lower than last year. Demand for first mortgages is unchanged, according to contacts, but refinancing has dropped off considerably. Auto lending is also down. Competition for loans remains stiff. Rising interest rates have increased borrowing costs, squeezing net interest margins on fixed rate loans. Some contacts are pushing variable rate loans to help earnings.

Energy

Energy activity remains high, but domestic drilling has not responded much to higher oil prices. International activity continues to improve except in the North Sea and the international waters of the Gulf of Mexico. Contacts were optimistic about signs of a possible turnaround in North Sea activity.

Agriculture

High yields are expected to offset low cotton prices, but producers are concerned about high fuel prices and the removal of subsidies. Cattle producers continue to enjoy strong demand and high prices, despite the ban on beef exports to Japan and South Korea. Recent rains and cool temperatures have improved range and pasture conditions to the point where producers say conditions are conducive for herd expansion.

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Twelfth District--San Francisco

Reports from contacts indicate that economic activity expanded at a solid pace in the District in September and early October, although growth appears to have slowed slightly compared with the previous survey period. Price inflation for final goods and services remained low overall, but prices of energy and some key construction materials rose further. Upward wage pressures were limited; however, rising costs for health insurance benefits continued to push up total compensation costs. Sales of retail goods were solid and demand for services generally was strong. Manufacturing activity was mixed in recent weeks, with some sectors reporting solid growth and others noting some softening. Contacts reported improved demand and sales for District agricultural and resource products. Residential real estate activity remained robust in nearly all District markets with moderation in only a few areas. Conditions in commercial real estate were stable, with little movement in vacancy rates or lease prices. District banking contacts reported solid real estate lending and modest improvements in commercial and industrial lending.

Prices and Wages

District contacts reported low price inflation overall, peppered with some isolated pockets of price increases. In particular, prices for fuel and some key construction materials increased sharply. In response to higher energy prices, some public utilities have obtained or applied for rate increases. Generally slack labor markets are holding down wage inflation; however, many contacts continued to report substantial increases in health insurance premiums, boosting total compensation costs.

Retail Trade and Services

Contacts reported generally solid retail sales in most areas during the most recent survey period. However, some retailers raised concerns about inventory levels of apparel, as sales have reportedly been softer than expected. Sales of automobiles and light trucks jumped in September, spurred by generous incentives for some domestic brands. That said, there remained some unwanted inventories on car lots in the District.

Service providers throughout the District reported robust demand. Sales of advertising, communications, entertainment, and health-care services remained strong in recent weeks. Additionally, District seaports handled very high volumes, and backlogs worsened in Southern California. Travel and tourist activity reportedly was robust, especially in Southern California, where hotel occupancy rates were in the 90 percent range. In Hawaii, the tourism sector benefited from higher numbers of both domestic and international visitors.

Manufacturing

District manufacturers reported mixed conditions in September and early October. Sales of lumber and wood products remained strong; prices edged down slightly as supply increased to meet the high demand. New orders for machine tools showed some softening. Respondents at IT firms other than semiconductors noted that demand has improved modestly but less than expected. Although capacity utilization for semiconductor makers was at high levels, there were selected pockets of softening sales and unintended inventory accumulation.

Agriculture and Resource-related Industries

In the District agricultural sector, contacts reported improved demand and sales for most agricultural products, including beef cattle, cut flowers, tree fruits, avocados, and cotton. In the resource sector, contacts reported that electric utilities continued to make investments to expand generation capacity. Although prices for natural gas remained elevated in recent weeks, inventories of natural gas were at levels deemed adequate for the upcoming winter heating season.

Real Estate and Construction

District residential real estate markets remained robust in recent weeks with only a few exceptions. Home demand and sales were especially strong in California's central valley, where prices are much lower than in that state's coastal communities, and in Arizona, where affordability remains high. Additionally, in Hawaii, high demand continued to push prices up rapidly. By contrast, demand and sales softened in parts of Southern California, as witnessed by increased time on the market and prompting builders to increase incentives. Demand for new homes and home improvements kept overall construction activity at high levels; contacts in all areas reported further shortages of steel, cement, and other construction materials, which increased building costs and caused construction delays. On the commercial side, contacts generally noted little change in market conditions, with continued high vacancy rates reflected in relatively flat prices and rental rates.

Financial Institutions

District banking contacts reported overall solid loan demand. One area where demand for loans remained particularly robust was real estate lending. District commercial and industrial lending improved slightly, albeit from a low base. Several bank contacts noted that banks have faced increasing challenges in finding qualified borrowers; however, overall loan quality remained high. Banking contacts also noted that ample credit was available.

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