



March 9, 2005

Summary of Commentary on Current Economic Conditions by Federal Reserve District

Summary

Prepared at the Federal Reserve Bank of New York and based on information collected on or before February 28, 2005. This document summarizes comments received from businesses and other contacts outside the Federal Reserve and is not a commentary on the views of Federal Reserve officials.

Information received from District Banks suggests that the economy has continued to expand at a moderate pace since the last report. All twelve Districts indicated that economic activity has increased, though Richmond reported some deceleration in the pace of growth, while Dallas noted some acceleration. Relatively brisk growth was reported in the New York and San Francisco Districts.

Consumer spending was steady to up moderately, with a number of Districts noting sluggish auto sales. Retailers were mostly satisfied with current inventory levels and were generally optimistic about the outlook. Travel and tourism activity were characterized as strong, with a few exceptions. Reports from most other service industries also showed improvement. Nearly all Districts reported continued expansion in manufacturing activity. Housing markets and residential construction activity were described as robust in most areas, but commercial real estate markets were mixed. Most Districts reported little change in overall loan demand, though a few indicated some pickup.

Labor markets strengthened in almost all Districts; while wages continued to increase at a moderate pace, employers in many Districts reported ongoing pressures from higher benefit costs. Many Districts reported increased difficulty in locating skilled workers for at least some industries. A number of Districts reported increases in prices for manufactures and materials, but others noted some easing of input costs; prices of consumer goods and services were mixed but relatively flat, on balance.

Consumer Spending and Tourism

Consumer spending has been steady to somewhat stronger since the last report. Overall retail sales strengthened in Boston, Philadelphia, Atlanta, Minneapolis, Kansas City, and Dallas. However, sales were reported to have been little changed in the other Districts. A number of reports from retailers indicated that apparel sold well, but others noted weak sales of electronics and big-ticket items. Automobile sales have been steady to softer in early 2005. Vehicle sales weakened in Richmond, Kansas City, Dallas, and San Francisco, while sales were said to be mixed in Cleveland, St. Louis, and Minneapolis. The Philadelphia, Atlanta,

and Chicago Districts reported that auto sales picked up in February, after a sluggish January. Overall, retail inventories were said to be at satisfactory levels, though automobile inventories were said to be on the high side in Philadelphia, Chicago, St. Louis, and Dallas.

Tourism showed increased strength in most Districts, though a few reported that activity was hampered by unfavorable weather. Robust tourism activity was noted in New York, Richmond, Atlanta, Kansas City, and San Francisco; New York attributed some of the strength to the Central Park "Gates" exhibit, Richmond cited unseasonably warm weather, and Atlanta noted some positive effect from the weaker dollar. On the other hand, Boston and Minneapolis indicated some softness in tourism, partly attributed to an unusual geographic distribution of winter snow.

Services

Activity in service-sector industries showed signs of strengthening since the last report. Boston, St. Louis, and San Francisco reported some pickup in demand for information technology services. New York reported strong conditions in the securities industry, and Dallas noted brisk demand for accounting services. Widespread strength was evident in the trucking and shipping industries: conditions were described as robust in Cleveland, Atlanta, St. Louis, Dallas and San Francisco, and steady in Richmond. Conditions in the airline industry were mixed: Dallas reported weak conditions, while Chicago noted strong demand from business travelers, but some softness in the domestic leisure segment. More broadly, St. Louis and San Francisco cited general increases in service-sector activity, while Richmond reported that conditions were stable.

Manufacturing

Manufacturing activity was reported as expanding solidly in most Districts, although the pace of growth has generally not increased since the last report. Many Districts noted particularly strong gains in durable goods manufacturing. Defense-related production was reported as strong in the Boston, Atlanta, Kansas City, and Dallas Districts; machine tool production was described as solid by several Districts; vehicle production remained at a high level, in part because of the strength in demand for heavy trucks; and construction materials were in high demand. Steel shipments softened in Cleveland, but were reported as solid in Chicago; Cleveland cited surging steel imports, whereas Chicago saw imports decline. High-tech manufacturing activity was reported as growing in the Dallas and Boston Districts but mixed in San Francisco, where the semiconductor industry showed strength but the telecommunications industry remained weak.

Sustained increases in the cost of energy, steel, and other materials were widespread. However, some moderation in the pace of cost increases was reported by the New York, Philadelphia, and Cleveland Districts, with a faster rate of increase noted only by the Richmond District. A recent drop in energy prices was cited by some Districts as helping to stabilize input price increases. The weaker dollar reportedly has stimulated exports in the Atlanta District, although some Districts cited the dollar's decline as exerting continuing upward price pressures on imported inputs. Several Districts noted that their manufacturing contacts were optimistic that the coming year would bring continued growth, with some seeing expansion of factory headcounts.

Real Estate and Construction

Home sales markets remained strong across most of the nation. New York, Philadelphia, Richmond, Atlanta, Chicago, St. Louis, and San Francisco continued to describe housing

markets as robust. However, mixed conditions were reported in Cleveland, Minneapolis, Kansas City, and Dallas. The market for apartments was characterized as soft in Dallas, mixed in Chicago, but strong in New York. Home construction has been particularly brisk in the San Francisco and Atlanta Districts, whereas Minneapolis, Kansas City, and Dallas indicated some pullback.

Commercial real estate markets were, on balance, stable. Office markets were steady in Boston, New York, Philadelphia, Richmond, St. Louis, and Dallas, with Boston and Dallas noting substantial ongoing slack in the market. On the other hand, some firming was reported in the Atlanta, Minneapolis, Kansas City, and San Francisco Districts. Philadelphia, St. Louis, and Minneapolis reported some pickup in the market for industrial space, but Boston, New York, and Richmond reported steady to somewhat softer markets. Richmond noted a slight decline in retail vacancy rates.

There were scattered reports of increases in commercial construction activity. Philadelphia reported an increase in industrial building, Cleveland reported a pickup in retail construction, and Richmond noted two major office projects in the pipeline. Some general, albeit modest, increases in commercial construction were also reported in Chicago, St. Louis, and San Francisco.

Banking and Finance

Banks reported steady to somewhat stronger lending activity in early 2005. The Philadelphia, Cleveland, and Richmond Districts noted increases in overall loan demand. Rising demand for commercial mortgages was reported in New York, Cleveland, Richmond, and Kansas City, while San Francisco described demand as slowing but strong; Dallas, however, noted an increase in commercial property foreclosures. Business lending also strengthened in a number of Districts, but the reports on household loan demand were mixed, suggesting little change, on balance, for both consumer loans and residential mortgages. Home equity lending strengthened noticeably in the Philadelphia and Cleveland Districts but slipped in Kansas City.

Credit standards were unchanged across the board, and loan quality was widely described as steady and strong. Contacts in Chicago, Dallas, and San Francisco indicated that the lending environment was highly competitive, leading to narrowing margins, while contacts in Dallas expressed some concern about excessive supply of funds available to commercial mortgage markets.

Agriculture and Natural Resources

Above-average rainfall and moisture levels were reported in several Districts, which created a mix of favorable and unfavorable conditions. In the Dallas, Kansas City, and St. Louis Districts, heavy precipitation helped planting conditions for the winter wheat crop but proved problematic for other crops. Improved conditions for livestock grazing were reported in the San Francisco, Dallas, and Kansas City Districts. Atlanta's citrus industry continued to suffer from the after-effects of last year's hurricanes, as well as disease.

Activity in the energy industry was reported as buoyant and optimistic, given the continuing pattern of higher energy prices. The Dallas and Kansas City Districts reported an increase in active rigs since the last report. Capacity in the industry is being strained by labor and equipment availability, although activity is expected to continue to improve.

Labor Markets

Labor markets across the nation have been steady to stronger since the last report. Ongoing improvements in labor market conditions were reported in Boston, New York, Atlanta, and Minneapolis, and hiring activity has picked up recently in Richmond, Chicago, and Kansas City. Brisk gains in temporary employment were seen in Boston, Richmond, Atlanta, and Chicago, while, in Dallas, these job gains fell short of expectations.

Manufacturers were reported to be raising employment in the Boston, Philadelphia, Cleveland, Chicago, and Minneapolis Districts. On the other hand, manufacturing employment has been steady to lower, on net, in Atlanta, St. Louis, and Kansas City. A number of industries have seen tightening labor markets across several Districts. Increased labor demand was reported in financial services (Boston, New York, Kansas City, and Dallas), legal services (New York, Minneapolis, and Dallas), and freight transportation and distribution (Cleveland, Richmond, St. Louis, and Kansas City). There were also reports of scattered skilled labor shortages in many Districts. New York and Cleveland noted a dwindling supply of skilled workers to fill job openings generally; and a number of other Districts reported shortages of skilled job applicants in specific industries, such as trucking, shipping, construction, energy, health care, and media.

Overall wage increases were characterized as moderate in all Districts. Still, a number of Districts cited larger wage gains in certain industries, including securities (New York), trucking (Cleveland and Kansas City), legal services (Minneapolis and Dallas), pharmaceutical services (Kansas City), and accounting (Kansas City and Dallas). Reports of ongoing sharp increases in benefit costs, particularly health insurance, were fairly widespread.

Prices

Retail prices were generally flat or up modestly; however, businesses continued to face rising input costs, and a number of Districts indicated greater ease in passing along price increases. Prices for finished goods were reported to be increasing modestly in Richmond and Minneapolis, but almost all of the other Districts characterized retail prices as flat. Cleveland and Chicago reported that motor vehicle prices were being reduced by increased incentives and discounts. A number of Districts also noted ongoing declines in apparel prices.

Despite the stability in consumer goods prices, manufacturers in a number of Districts--including Boston, Cleveland, Kansas City, and Dallas--indicated that they have been finding it increasingly easy to pass along price increases; Philadelphia producers anticipated greater ability to boost prices in the near future. Also, truckers in the Cleveland and Atlanta Districts indicated that they have been offsetting rising fuel costs with surcharges.

A number of Districts reported persistent pressures on input costs, though some noted that these have eased since the last report. Firms in Boston, Richmond, Atlanta, Minneapolis, Dallas, and San Francisco reported sizable increases in prices of various raw materials. The most commonly mentioned were construction materials (especially steel) and fuel. Quite a few Districts also mentioned continued rapid escalation in health insurance costs, though San Francisco indicated that these have decelerated. More generally, New York, Cleveland and Chicago indicated that input cost pressures have abated somewhat since the last report.

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First District--Boston

Economic activity continues to grow in the First District. Retail and manufacturing contacts mostly say sales or revenues are ahead of year-earlier levels. Manufacturers express concern about rising costs. Software and information technology services cite rising demand, while staffing firms continue to report job growth. Employment is also generally rising, albeit modestly, among respondents in manufacturing and software and IT services. Only commercial real estate markets have failed to improve.

Retail and Tourism

Most First District retailers report positive sales growth in January and February, although the severity of the winter is hurting casual dining and helping pharmacies. Year-over-year sales ranged from down 4 percent to up 8 percent among respondents. Sales of children's and sports apparel are strong, and sales of lumber continue to be especially strong.

Inventories are slightly up or beginning to level off according to contacts. Vendor prices are generally stable, with some exceptions (both up and down modestly) for food-related items. On the retail side, clothing prices are falling slightly and casual dining prices are up modestly. Employment and wages are steady. Respondents report flat or rising capital spending, with the spending concentrated on upgrading technology and opening new stores.

Tourism-related contacts say travel this winter to New England, with the exception of Boston, has been slow compared to a year ago, largely because of heavy snowfall in Massachusetts and lower-than-average snowfall in the northern states. Respondents expect the weak dollar to encourage international travel. They also hope that improved consumer confidence will boost demand for luxury activities and venues, which have been outpaced by moderately priced hotels and restaurants during the past year.

Most retailers believe the economy is strong and consumer confidence is recovering. They anticipate modest 3 percent to 5 percent gains in 2005. Multiple contacts express concern over health care costs, gasoline prices, and competitive pressures.

Manufacturing and Related Services

Almost all First District contacts in manufacturing and related services report that sales and orders in late 2004 and early 2005 have been above year-earlier levels. Companies cite particularly strong gains for defense-related equipment and exports of various kinds. Demand for semiconductors appears to be recovering after falling into a slump, but sales of some categories of consumer nondurables are said to be sluggish.

While demand for manufactured goods is generally strong, many firms are concerned about sustained increases in materials costs, the declining purchasing power of the dollar in foreign markets, or sharply higher utility bills. Contacts complained of double-digit cost increases for steel, ceramic products, petrochemicals, rubber, plastics, electricity, and natural gas. Some respondents have managed to raise their selling prices and productivity enough to offset margin pressures, but others have not. Several manufacturers report that their customers have become more willing to pay higher prices. By contrast, a couple of contacts indicate they are being more choosy in taking on business out of concern that margins may be inadequate. Selling prices for technologically sophisticated products continue to be flat to down compared to a year earlier, and these types of firms are not as affected by rising input costs as other respondents.

A majority of contacted manufacturers are increasing their U.S. headcounts, mostly in

professional and technical positions. Pay increases are generally running in the range of 3 percent to 4 percent. Most respondents intend to keep capital spending roughly unchanged from the amounts spent in 2004, but some that had recently invested in major productivity enhancements report that they are bringing capital spending back down to a "normal" level.

Manufacturers tend to see positive business trends continuing in the coming year. Their biggest concerns relate to margin pressures associated with rising materials costs and uncertainty about their own pricing power.

Temporary Employment

Temporary employment agencies in the First District continued to experience decent rates of demand growth in late Q4 and the first two months of 2005. Employment in technical, manufacturing, financial, and defense-related occupations is up strongly. Respondents are further pleased that the volume of permanent and temporary-to-permanent employment continues to grow. The available supply of labor seems to be declining somewhat, particularly in skilled areas. Most responding temp firms are achieving modest price increases, or at least an end to downward price pressure. Health insurance, worker's compensation, and state unemployment insurance costs are rising. Despite other ongoing concerns such as outsourcing, respondents are generally optimistic about 2005 and beyond.

Commercial Real Estate

Not much changed from November through January in New England commercial real estate markets. Vacancy rates remain high and rents are low, albeit without substantial deterioration in the past quarter. Although some contacts report that markets in Boston are "beginning to firm," others report no improvement. Some parts of the region have experienced positive market absorption, but several large mergers have led to large amounts of office and industrial space being added to the Boston market. In 2004, Boston experienced the fourth consecutive year of negative market absorption, its worst streak on record. Office vacancy rates remain in the mid-teens in Boston and exceed 20 percent in the suburbs. Nevertheless, demand for purchasing office buildings remains strong and sale prices for high-rise office buildings are still very high. Contacts do not expect commercial markets to improve until the region's economy strengthens and new jobs are added.

Software and Information Technology Services

Business results range from flat to "going well" for First District contacts selling software and information technology services. Revenues in the most recent quarter (generally ending in December or January) were 8 percent to 20 percent higher than a year earlier, but several respondents indicate that all or much of the growth reflects special factors such as foreign currency gains or acquisitions. All contacts report that their industry is above its recent bottom, but most note that customers are still very selective; they are watching costs carefully and buying mission-critical, business-driven, or very high return-on-investment items.

Contacted companies are adding technology workers and sales staff, although not hiring aggressively. One firm is continuing a "moderate pace" of hiring, while another indicates its plans include "only a handful" of net new hires. One responding company just eliminated a wage freeze that had been in place for over three years; several other firms report 3 percent annual pay increases. Contacts cite little change in capital and technology spending.

Looking forward, software and IT respondents say the situation is favorable. They expect

more of the same in the next few quarters--revenues and profits are generally projected to continue growing at current rates.

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Second District--New York

The Second District's economic expansion has been well maintained since the last report, while price pressures have been relatively subdued. Manufacturers report continued moderate growth in activity in February, and some moderation in price pressures. Retailers indicate that February sales were little changed from a year earlier but generally close to plan; however, tourism activity is reported to have been unusually strong in early 2005. Residential real-estate markets showed further signs of strength in January and February, while both office and industrial markets were stable. The securities industry reports brisk business activity, as well as a pickup in hiring and compensation. Finally, bankers report little net change in loan demand and steady to declining delinquency rates.

Consumer Spending

Retailers report that sales were mixed but, on balance, close to plan in February and little changed from a year earlier. A boost in apparel sales from New York's one-week holiday from sales tax on moderately-priced apparel (January 31-February 6) and a strong pickup in sales to tourists appear to have been offset by unseasonably cold and wet weather. A number of contacts indicate fairly brisk apparel sales but relatively sluggish sales of home furnishings and equipment. Inventory levels were mostly described as satisfactory. Retail chains indicate that prices were steady to down slightly, compared with a year earlier. Consumer confidence was little changed in February, as in January, based on the Conference Board's latest survey of Middle Atlantic state (NY, NJ, PA) residents.

New York City tourism has been exceptionally strong in early 2005. In January, Manhattan's hotel occupancy rate was up about 3 percentage points from a year ago, and total revenues were up roughly 15 percent. More recently, an industry contact reports that most Midtown and Uptown hotels were completely booked for most of February, largely spurred by visitors to the Christo "Gates" in Central Park. In the third week of the month, hotel revenues were reported to be up by roughly a third from comparable 2004 levels. Museum attendance was also said to be exceptionally high in the second half of February. Broadway theater attendance was sluggish in the first half of February but picked up moderately in the third week of the month. Finally, Buffalo-area hotels report that occupancy rates have been running roughly on par with a year earlier, as stronger underlying demand was said to be offset by the cancellation of National Hockey League games.

Construction and Real Estate

Housing markets were generally characterized as robust in the first two months of 2005. New Jersey homebuilders note that a modest inventory build-up last December turned out to be short-lived and that demand remains strong. Moreover, the state's major builders' association reports particularly strong registration for their upcoming annual conference. Similarly, New York City's co-op and condo market is characterized as increasingly tight in early 2005, particularly for smaller (1 bedroom and studio) apartments; overall, prices are reported to be running 10-20 percent ahead of last year, though the number of transactions is down somewhat, reflecting a dearth of units on the market. Manhattan's apartment rental market has been holding steady thus far in 2005, with rents estimated to be up 5 percent from

early-2004 levels; however, the very high end of the market is described as relatively strong, reportedly buoyed by apartment-seekers shifting from the sales to the rental market.

Commercial real estate markets in and around New York City were relatively stable in the first two months of 2005. Compared with year-end 2004, office vacancy rates edged down in Midtown Manhattan and northern New Jersey but edged up in Lower Manhattan and Long Island; asking rents were also little changed. For all of Manhattan, an industry contact reports that the volume of available sublease space fell to its lowest level since September 2001. Industrial vacancy rates held steady on Long Island, in January and February, but edged up in New York City and climbed to a nearly two year high in northern New Jersey, partly reflecting new supply of space.

Other Business Activity

Manufacturers report continued moderate growth in activity in February, along with some moderation in price pressures. Our latest survey of New York State manufacturers indicates steady growth in manufacturing activity in February; there was a pickup in shipments but a dip in unfilled orders. Increases in both current and expected selling prices were more subdued than in recent months. Purchasing managers in the Buffalo area note some deceleration in manufacturing activity, as well as some moderation in price pressures, in February. However, purchasers in the New York City area indicate a modest rebound in manufacturing activity, following some softening in December and January, along with little in the way of price pressures.

A major New York City employment agency reports that hiring activity remained fairly brisk in February, but has not strengthened noticeably from late 2004. Our contact indicates that the quality of job candidates available to meet openings is lower than last year. Most of the hiring is still reported to be coming from the financial and legal sectors, but there has been a scattered pickup in other industries such as fashion, pharmaceuticals, and executive placement. The securities industry has continued to perform well in early 2005; despite some slowing in equity issuance, other business segments are reported to be strong. Moreover, employment continues to grow, despite scattered layoffs, and total wages and salaries the first quarter are estimated to be running 10 percent ahead of a year ago, led by a 15 percent increase in bonuses.

Financial Developments

Small to medium-sized banks in the Second District report little change in overall loan demand. Bankers report reduced demand for residential mortgages and commercial and industrial loans, but steady demand for consumer loans and increased demand for commercial mortgages. Bankers again report no change in credit standards across all loan categories. Interest rates rose across all loan categories except residential mortgages, where rates are reported to be unchanged. Average deposit rates rose, according to 80% of respondents, with no banker reporting a decline. Bankers report little change in delinquency rates for the household sector, but slight declines for nonresidential mortgages and commercial and industrial loans.

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Third District--Philadelphia

Business activity in the Third District increased in February. Manufacturers reported rises in

orders and shipments during the month. Retail sales of general merchandise were up modestly compared with the previous month and with February of 2004. Auto sales rose slightly from January to February but remained below last year's level. Banks and other lending institutions reported that lending continued on an upward trend. Commercial real estate contacts described market conditions as steady. Residential real estate agents indicated that existing home sales were running at a roughly steady pace, with continuing price appreciation. Homebuilders generally reported a pickup in sales in February after a slowdown in December and January.

Contacts in the Third District business community generally expect further improvement in the region's economy in the months ahead. Increases in shipments and orders are expected by manufacturers during the next six months. Retailers anticipate moderate year-over-year gains during the spring sales season, but auto dealers say the outlook is uncertain. Bankers forecast a continued rise in overall lending, with gains in business and home equity lending. Commercial real estate companies expect market conditions to improve during the year. Residential real estate agents foresee a pickup in home sales during the spring, but they expect sales for the year as whole to be somewhat below last year.

Manufacturing

Manufacturing activity in the Third District increased in February. Around four in ten of the manufacturing firms surveyed during the month reported an increase in shipments compared with January, and around one in three reported higher orders; around two in ten reported decreases in these measures. Order backlogs at area plants were virtually unchanged from January to February, but delivery times increased somewhat. Growing business was reported among firms in most of the District's major manufacturing industries.

The region's manufacturers generally expect further gains in business activity. Nearly half of the firms surveyed in February expect their shipments and orders to increase during the next six months, and slightly more than one in ten expect decreases. On balance, area manufacturing firms are scheduling increases in capital spending and planning to add employees.

Third District manufacturers reported rising prices in February. The number of firms reporting increases in input prices declined from January to February, but the number raising prices for their own products in February was the same as in January. During the next six months almost two-thirds of manufacturers expect increases in input prices, and nearly one-half expect increases in the prices of their own goods. This represents a more widespread expectation of higher prices than in January.

Retail

Retailers reported moderately increased sales in February compared with January and with February of last year. Store executives indicated that winter merchandise has been mostly cleared out through discounting and that spring apparel was selling well. Most of those contacted for this report said sales in recent weeks have been running close to plan, although inventories have increased as spring merchandise shipments have been received. Store executives generally forecast a modest year-over-year increase in sales for the spring selling season. Most of the retailers surveyed said costs of goods have been practically unchanged recently, but some expect increases for fall merchandise. Store officials noted continuing increases in costs for employee benefits.

Auto dealers in the region reported a slight pickup in sales in February compared with January, although the sales rate remained below the rate in the same months in 2004. Inventories were described as high, except for some imported models. Most of the dealers polled in late February said the immediate sales outlook was uncertain, although they anticipate sales for this year as whole will be down from last year.

Finance

Outstanding loan volume at Third District banks rose in February compared with January, according to banks surveyed for this report. Nonbank lending institutions also reported growing loan volumes. Commercial and industrial loans have been increasing, with new borrowing being done by firms in a wide range of industries. Bankers also reported increases in personal loans, especially home equity loans and credit lines. Bankers and other lenders in the District expect overall lending to rise through the year, with further gains mainly in business and home equity lending.

Real Estate and Construction

Commercial real estate firms in the Third District reported that vacancy rates in the region's office markets have been roughly steady, on balance, in the past few months. There have been slight increases in some areas, including Philadelphia's central business district, and slight decreases in other areas. Rental rates have also been mixed, although recent changes have been mostly slight. Commercial real estate firms expect office vacancy rates to move down through the year in most parts of the region as economic activity and hiring expand. Industrial building vacancy rates have declined slightly in recent months, but rents have been nearly steady. Commercial real estate contacts noted an increase in speculative construction of warehouse and other industrial buildings, which they believe reflects optimism among developers that regional economic conditions are improving.

Residential real estate agents indicated that sales have been roughly steady in recent weeks at a strong pace. Homebuilders reported a pickup in sales in February after a slowdown in December and January. House prices continue to appreciate, but some real estate agents noted that increased asking prices for homes in the highest price range have resulted in a slower sales rate. Both builders and real estate agents expect the pace of sales to accelerate somewhat as spring approaches, although they anticipate sales for the year as a whole will be slightly below last year.

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Fourth District--Cleveland

Through the first two months of 2005, the economic environment in the District improved across an array of industries. Reports from retailers signaled a slight strengthening in business conditions. And production among the District's durable goods manufacturers generally rose as well, while nondurable goods makers saw steady production levels in early 2005. Residential builders reported better sales in recent weeks, though sales levels were less than at this time last year, and nonresidential contractors continued to report modest improvements in their industry. At District banks, borrowing by businesses continued to strengthen. Finally, demand for shipping services remained robust.

While concerns about increases in some materials prices were reported, most input costs rose less rapidly or even fell throughout the last several weeks. Plans to expand employment still

seem isolated, though staffing services companies reported that the number of job openings increased in recent weeks, and is dramatically higher than at this time a year ago. While contacts indicated that workers were not hard to find, some jobs requiring specific skills were reportedly becoming more difficult to fill.

Manufacturing

Production at the District's durable goods producers appeared to trend up through the first two months of 2005. This differs from the final months of 2004, which were marked by flat or falling production levels on a month-over-month basis. Production also appeared to be up slightly on a year-over-year basis at most District durable goods facilities, and new orders have generally grown since the start of the year, leaving many contacts cautiously optimistic. Automobile production at District facilities was also above the levels of this time last year despite planned production cuts at some automakers. However, domestic steel shipments softened somewhat in the early part of 2005, though they remained at high levels. Most contacts continued to think that the demand for steel was solid, and attributed the declines to increases in inventories among steel distributors and a surge in imports.

Nondurable goods makers generally reported that production levels were steady for the first two months of 2005, and about the same as a year ago. Refineries, in particular, reported strong sales. Most nondurable goods producers did not anticipate a significant change in the economic environment in the months ahead.

For most manufacturers, input cost increases appeared to abate, especially for food and energy items. While steel spot prices have fallen in recent weeks, price increases for inputs into the steel production process--especially coking coal and iron ore--were widely reported. Additionally, many steel contracts are currently being renegotiated, and may result in increased effective steel prices for many firms. Few nondurable goods producers planned any capital additions or hiring; however, hiring plans were more widespread among durable goods manufacturers. While most durable goods producers planned to keep their capital spending at about the same levels, those producers that planned increases wanted to expand capacity to accommodate an anticipated increase in demand.

Retail

Reports from retailers suggested some improvement in the economic environment in early 2005, though contacts continued to note that sales activity was weaker throughout the Midwest. Discount retailers reported that their sales were generally as expected through the first two months of 2005 and modestly above the levels of a year ago. One contact suggested that the improvement in sales was due to declining gasoline prices, which may have left consumer with more money to spend on other items. Specialty retailers reported results that were similar to discounters', if more mixed, and contacts expect good sales growth in the months ahead. Department stores, by contrast, continued to struggle, reporting that sales throughout the early part of 2005 were down from this time a year ago and below expectations.

Auto sales were mixed throughout the District, though trucks and SUVs continued to sell well. Widespread incentives continued to cut the effective prices of new automobiles. Outside of autos, prices in recent weeks were stable, with a few exceptions. Some apparel product prices were aggressively reduced according to contacts, while prices for products made with steel were said to be higher.

Construction

New home sales and customer inquiries improved in early 2005 for most residential builders relative to the last six weeks of 2004, even after accounting for seasonal factors.

Nevertheless, sales for many District builders were down on a year-over-year basis. Isolated input cost increases--for items such as steel, concrete, and lumber--that most companies can only partially offset have put pressure on builders' profit margins. Additional increases in concrete and lumber prices are anticipated. Regarding the outlook, many builders expect slower sales in the first half of 2005 than they saw throughout the first half of 2004.

Nonresidential construction activity in the District increased modestly in recent weeks, relative to the end of last year. Client inquiries also increased in early 2005. Among the nonresidential construction categories, several contacts cited particular improvements in building related to the retail sector. However, most nonresidential builders' backlogs remain light. In general, contractors expect construction activity to improve throughout this year, albeit at a measured pace. As with residential builders, increases in materials costs were cited by nonresidential builders, for items such as steel products and insulation. While builders have attempted to pass these price increases on to their clients, they have had mixed success.

Banking

Large banks in the District generally reported some increase in loan demand among both their commercial and consumer clients. Loan demand was described as broad-based across commercial lending categories. For consumers, some large institutions indicated that home equity lending was especially strong; however, demand for mortgages and automobile loans appeared to be down somewhat. Smaller banks generally reported less robust activity, with commercial loan demand increasing only modestly, though more than in the consumer categories. Many banks noted that their deposit growth was flat or falling, but some contacts suggested that seasonal patterns partly explain the weakness.

Trucking and Shipping

Activity among trucking and shipping services providers continued to be strong through the early part of 2005, and above year-ago levels. Moreover, contacts described demand as strong across an array of industries. Accordingly, despite the strong demand seen throughout the last year, many firms are forecasting an even stronger 2005. Limited capacity, however, concerns contacts. Companies continued their attempts to attract workers through better benefits and wages, but have been unable to draw enough employees to meet demand. Firms are also planning truck purchases, but there are long lead times for delivery. Finally, any increases in fuel costs continued to be offset through surcharges.

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Fifth District--Richmond

Fifth District economic activity expanded at a somewhat slower pace in January and February as modestly higher growth in manufacturing and tourism was tempered by weaker growth at services firms and nearly flat retail sales. District services firms reported that their revenues rose more slowly since our last report, while retailers said that their sales leveled off. Manufacturing increased at a slightly stronger pace as new orders picked up in January and shipments increased somewhat in February. District real estate agents continued to describe housing markets as vibrant and bankers said lending increased in most categories.

Reports on tourism were upbeat, characterizing tourist spending as strong and noting that some District hotels were booked to capacity in February. Turning to prices, contacts indicated that increases for most final goods and services remained modest, despite higher raw material prices in the manufacturing sector. In agriculture, small grains crops were in good condition and land preparation for spring planting was underway in the District's southern reaches.

Services

Services businesses reported that their revenues rose at a more moderate clip in January and February. District freight transportation contacts generally said that their business was steady, while respondents at health systems and hospitals in North Carolina, Virginia, and West Virginia gave mixed reports on the strength of demand for health services. The president of a Washington, D.C., firm providing training in foreign languages reported "some new business, but not much." Contacts at several catering services noted particularly slow business in part because of fewer requests from corporate clients. Wage growth softened at services firms, although our contacts noted that hiring picked up. Prices in the sector continued to rise at a modest pace.

Retail

District retailers reported that their sales leveled off in February. A contact at a department store in the Washington, D.C., area said their sales were little changed and indicated that customers were increasingly looking for "clearance deals." A manager at a department store in central North Carolina also described sales as relatively flat. Adding to the dull tone, sales of big-ticket items also remained sluggish. Automobile dealers in southern Maryland and in the Tidewater area of Virginia reported softer sales, while dealers in central North Carolina and western Virginia said their sales were little changed. Retail hiring generally slowed although wage growth picked up somewhat. Prices in the retail sector rose only modestly in January and February.

Manufacturing

District manufacturing activity expanded at a somewhat stronger pace since our last report. New orders picked up during the January/February period, and shipments moved higher in February. Among industries, manufacturers of apparel, lumber and wood products, and furniture reported the strongest growth in shipments. A furniture maker in Sumter, S.C., for example, said shipments and new orders were both higher in February, while a counterpart in Hagerstown, Md., told us that their order backlog was "keeping them busy." A plastics manufacturer in North Carolina was also upbeat. "Our level of activity is good and backlog is higher than it's been in years," he noted. But prices of raw materials rose at a quicker pace and several respondents suggested that higher raw materials costs were squeezing their profit margins.

Finance

District loan officers reported somewhat stronger loan demand since our last report. Bankers said that commercial lending increased moderately and that lending for capital spending and commercial real estate investment had picked up. A banker in Charlottesville, Va., said that the local economy continued to improve and he expected to "put a lot of [commercial] loans on the books" in the next few weeks. In addition, a Charlotte, N.C., contact reported that commercial lending had been "very strong" in that area. Residential mortgage lending was moderately higher as well, although mortgage refinancing activity was light. A banker in Richmond, Va., said that home mortgage lending rose in recent weeks and that he expected to

see a decent market in coming weeks since mortgage interest rates remained "pretty good."

Real Estate

Fifth District real estate agents told us that the demand for housing remained strong. An agent in Odenton, Md., said that the previously "overwhelming" local market was now "more subdued," but noted that people were still waiting in line to grab residential lots as they became available. In Richmond, Va., a real estate agent described January and February sales as "great." He added that the housing market continued to "steam ahead," and complained of a shortage of inventory. In the Washington, D.C., area, a contact reported a very "positive housing market" with multiple offers on properties still common. He predicted home sales in the Anacostia area of the city would rise sharply over the next five years if a proposed new stadium for the Washington Nationals baseball team is constructed there. Home prices continued to rise in most areas of the Fifth District.

Commercial real estate agents reported that leasing activity increased only modestly during the first two months of 2005. "Things have been pretty much status quo since the first of the year. However, we anticipate a busier spring," noted a contact in Raleigh, N.C. Industrial leasing remained a weak spot in January and February, while office and retail leasing was generally flat outside of the Washington, D.C., market. In the Washington, D.C., area, strong job creation continued to underpin brisk growth in office leasing, and contacts reported that demand for investment properties continued to outstrip supply in that area. Commercial leasing agents noted that rents "held steady" during recent weeks and that office and retail vacancies edged lower. While construction activity has been generally quiet throughout the Fifth District since the first of the year, a contact in Charlotte, N.C., reported plans for two new downtown bank buildings.

Tourism

Tourism activity strengthened since our last report. A manager at a ski resort in West Virginia described the Presidents' Day weekend as the busiest in the history of the resort. A counterpart at a Virginia lodge noted that the number of skiers was down slightly because of the unusually warm weather, but said that sales of time shares were up. Tourism along the coast was also stronger. A contact in Myrtle Beach, S.C., reported significant increases in bookings for both Valentine's and Presidents' Day weekends--he added that many hotels were turning business away because they were booked to capacity. On North Carolina's Outer Banks, spring-like weather boosted holiday bookings and tourist spending.

Temporary Employment

Fifth District temporary employment agencies reported somewhat stronger demand for workers in January and February. An agent in Raleigh, N.C., said continued recovery in the local economy had boosted demand for workers from his agency. A Northern Virginia agent reported that a number of companies in her area were downsizing and would likely need additional temporary employees as substitutes for permanent staff. Across the District, workers with administrative and sales skills and those with distribution and warehouse experience were most highly sought.

Agriculture

Weather conditions across the District varied widely during most of January and February as periods of mild, dry weather were followed by periods of ice and snow. Farming activity in North Carolina and Virginia was limited at times by the cold weather. But warmer weather in parts of South Carolina led to earlier-than-usual land preparation in that area. In addition,

respondents reported that small grain crops were in good condition in most areas of the District.

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Sixth District--Atlanta

Sixth District business contacts reported that the pace of economic activity remained quite positive in late January and February. Most retailers reported steady sales growth and balanced inventories, and auto dealers noted that sales improved modestly in February. Homebuilders and Realtors indicated that construction and sales continued to post gains, but have decelerated in many parts of the District outside Florida. In Florida, conditions remained very strong. Nonresidential construction contacts continued to report modest improvement. Reports from the manufacturing sector were mostly positive, and demand for transportation services remained very strong. Tourism officials in Florida were upbeat, with contacts in the central and southern parts of the state noting an increase in foreign visitors. Labor market conditions were generally positive, but businesses continued to approach hiring cautiously. Price increases were noted for several industrial inputs and building materials, and contacts continued to note rising healthcare costs.

Consumer Spending

Retail sales continued to grow moderately throughout the District. Gift card redemption boosted sales in January according to many retailers, and inventories through February were reported to be generally on target. Merchants noted that sales of women's apparel and home-related goods were particularly strong. District car dealers reported disappointing sales in January, but strong promotional programs improved traffic and sales in February. Industry contacts in Tennessee and Florida reported that commercial and fleet sales were better than expected.

Real Estate

District home sales and construction continued to be strong in late January and February, but the pace slowed from a year ago outside Florida where activity continued to be very brisk. In Florida, builders and Realtors reported very strong activity in housing construction and sales, especially in vacation areas along the coast. Home price acceleration was noted in many Florida markets, especially in south Florida, where some contacts expressed concern over increases in speculative purchases. Nevertheless, buyers continued to line up for new projects. Reports indicated that nonresidential construction continued to improve very modestly in late January and February. Office vacancy rates were gradually declining from high levels in several markets, and lease rates gained some traction.

Manufacturing and Transportation

Reports from the factory sector were mostly positive in late January and February. Several contacts noted that the weaker dollar was helping stimulate exports. However, a firm that imports components for computers and televisions cited increasing costs because of higher import prices. Military spending reportedly remained strong throughout the District. Although industrial power usage increased recently for some pulp and paper manufacturers, industrial power usage declined for textile plants. A large home furnishings manufacturer recently announced the closure of two Georgia facilities, eliminating nearly 600 jobs because of increased competition from imports.

Demand for transportation services continued to be strong. Contacts noted some plants had shortened factory hours because of capacity limitations of regional railroads. Freight demand retained the strong pace seen in recent months, led particularly by healthy gains in international shipments. Trucking contacts reported strong demand and higher profits; firms indicated that they were able to raise prices and pass through higher fuel costs to customers.

Tourism and Business Travel

Reports from the tourism and hospitality sector through February remained positive. The weaker dollar has had a positive impact on the tourism industry in Florida, and the number of European and Canadian tourists reportedly increased over a year ago. Improvement in several Latin American economies has also led to an increase in the number of visitors from that region to south Florida, in particular, where high hotel occupancies, increasing room rates, and growing restaurant sales were reported. In other areas of the state, hotel operators were receiving more inquiries than last year and expect stronger bookings ahead. However, tourism in northwest Florida is rebounding more slowly from the hurricane impacts.

Financial

Financial activity remained strong in the District, though some slowing in consumer loan demand was noted. For instance, auto financing reportedly slowed in January in parts of the District. Some banks were said to be paring lending to homebuilders. Commercial loan demand remained at low levels. Overall asset quality at District banks remained strong. Georgia companies attracted venture capital in record amounts in the fourth quarter of 2004.

Employment and Prices

Contacts again reported price increases in healthcare and for some industrial commodities. Energy and building materials prices increased, but contacts also noted an increase in price volatility for several related goods, which was making it difficult to predict short-term business costs. For example, a commercial contractor reported that recent steel price quotes were good for only 10 days. Major Florida theme parks increased their ticket prices. Labor markets were mixed. Businesses are cautiously hiring in parts of the District. A large temporary employment agency reported that business in January was up 20 percent over the same time last year. Help wanted ads were up in parts of the District, which was unusual based on seasonality. Labor shortages were reportedly keeping builders from fully meeting housing demand in Florida.

Agriculture

The outlook for Florida's citrus industry continued to be driven by reduced orange and grapefruit crop estimates. The orange crop, the smallest in over a decade because of hurricane damage, is now further threatened by the spread of citrus canker disease into the state's third-largest citrus producing county. On a more positive note, contacts remain optimistic about global demand for cotton and poultry. Poultry growers in particular are benefiting from firmer prices, lower costs of feed and strong demand.

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Seventh District--Chicago

The Seventh District economy continued to expand at a moderate pace in January and early February. A number of contacts reported that the auto industry was weighing down activity in other sectors of the regional economy. Consumer spending was again generally subdued,

and business spending continued to increase modestly. Reports on construction and real estate were mixed by location and market segment. Manufacturing output was relatively steady, but at high levels. Household loan demand was reported to be flat, while business loan demand generally expanded modestly. Overall cost and price pressures remained in check. District farmers formulated their planting decisions against a backdrop of large increases in seed, fertilizer, and energy costs, as well as lower crop prices than a year earlier.

Consumer Spending

Consumer spending was again generally subdued in January and early February. Only one large discount retailer noted "solid" sales that met expectations, while other retail contacts characterized sales as "soft" or "flat." Apparel and home-related goods, like tools, paint, and decorations, sold well, while sales of electronics were noticeably weak. One retailer in Iowa reported poor sales of weather-related goods, but noted that the unseasonably warm weather had an upside: low heating bills should leave area consumers with more cash to spend in March and April. Light vehicle sales in the District picked up some in February, but a Chicago-based dealer noted that sales in the area continued to trail those in the rest of the nation. Vehicle inventories were said to be high, with one dealership declining allocations for their three largest locations in January and February. A large restaurant chain reported that sales at Midwest restaurants were increasing more slowly than in previous months. Overall tourism activity in the District was similar to a year ago.

Business Spending

Business spending continued to increase modestly. Several contacts reported that they held to their capital spending plans, which call for moderate increases. One large bank noted that businesses have been borrowing for inventories and equipment. Business air travel was said to be "strong" on international routes, and the mix on domestic routes had moved more toward business travelers. Hiring continued at an equal or slightly faster pace than in the previous reporting period. A Chicago job board reported modest increases in job postings. Several manufacturing companies said that they are in the process of hiring some additional workers, and one temporary help provider noted "relatively strong" demand from manufacturers. Workers in health care, sales, accounting, and finance were all in demand. Overall, business sentiment was said to be positive, though many contacts qualified the level of optimism as "guarded" or "cautious."

Construction and Real Estate

Reports on construction and real estate were mixed by location and market segment. Residential activity picked up in many places during January, with one homebuilder in Chicago reporting a record month for its sales. In contrast, one contact in Michigan said that residential activity had been soft and thought it would remain so for the rest of the year. High-end home sales in Wisconsin were reported to be stronger than low-end home sales. Apartment vacancies were mixed, with tighter markets in Milwaukee and more openings in Indianapolis. Commercial development was reported to be quite active in many places. A contact in Indiana said that people wanted to close deals before interest rates moved higher. However, a contact in Michigan noted that development there was slow, adding, "The auto industry is really hurting us now." Rents for commercial space were steady, although a contact in Des Moines said that many incentives were still being offered.

Manufacturing

Manufacturing output was relatively steady in January and early February, but at high levels. Steel production continued its solid pace with most markets experiencing good demand.

Driven by strong demand for steel from overseas, imports of steel products into the U.S. have begun to decline. Inventories for steel products were characterized as "a bit high." Machine tool makers indicated that orders and shipments were strong, with orders in mid-February the best in many years. A representative from an aerospace company said that higher oil prices were actually helping the sales of new, more fuel-efficient planes. Production of heavy equipment remained strong in January, although there were reports of order inflows slowing a bit. The strength in heavy machinery was supported by demand for mining and construction equipment. In addition, production of heavy-duty trucks strengthened further in January. One industry analyst predicted high rates of heavy-truck production in 2005, although difficulties obtaining tires and some specialty steel products may limit output. Also, a tool manufacturer indicated that a truck engine producer was paying above-market prices in order to guarantee a supply of parts. In the light vehicle market, inventories were well above desired levels for many market segments, and production in the first quarter has been scaled back.

Banking and Finance

Overall lending activity was little changed from the previous reporting period. Household loan demand was reported to be flat during the past month, although mortgage lending improved in January after being soft in December. A contact at one large bank noted that households have shown a lot of interest in variable rate and shorter-term mortgages. There were no reported changes in consumer credit quality or standards and terms for household loans. More than one contact observed that business customers were borrowing with some hesitation, nonetheless business loan demand generally expanded modestly. Almost all contacts reported strong demand for equipment loans, and one large bank noted a pick-up in M&A activity. Several bankers commented that the competitive environment for business loans was putting pressure on margins and may be narrowing risk premiums. There were no reports of changes in business loan quality.

Prices and Costs

Overall cost and price pressures remained in check. Wage gains remained modest overall, though mixed by occupation and industry. A temporary help services firm said there was no pressure on their billing rates, while an airline enacted new labor agreements that cut wages for many of its employees. Health insurance costs were a concern for many contacts. Manufacturers reported that material costs, outside of oil-related products, continued to ease early into 2005. A few contacts said they increased prices in response to higher material or labor costs, but by and large price pressures were muted. An area auto dealer noted more rebate programs in February than in January, but added that the givebacks were still down from last year. Retailers reported no unusual discounting activity. An airline noted that domestic yield declines were abating and international yields were increasing.

Agriculture

Farmers in the District were making their planting decisions against a backdrop of large increases in seed, fertilizer, and energy costs, as well as much lower crop prices than a year ago. Accordingly, cash flow projections were down for this year. Proposed cuts in government payments had also added greater uncertainty to the outlook for farm income. Farmers responded by evaluating ways to cut costs, such as pooling resources and changing tillage practices. Contacts expected at least some shifting of acres planted this spring from soybeans to corn due to relative yields, government payments, and the threat of Asian soybean rust.

Eighth District--St. Louis

Economic activity in the Eighth District showed continuing signs of modest growth. In manufacturing, several contacts reported plans to open plants and expand, while some other contacts reported plans to close plants and lay off employees. In the services sector, most contacts continue to report improving economic conditions and job growth. In the retail and auto sectors, sales were reported as flat or slightly down in January and February with respect to year-earlier levels. Residential real estate markets continue to be robust, while commercial real estate remains soft, albeit showing some signs of improvement. Lending conditions are largely unchanged.

Consumer Spending

Contacts reported that retail sales in January and February were down by less than 1 percent, on average, over year-earlier levels. While 50 percent of the retailers surveyed noted that sales levels met their expectations, 38 percent reported that sales were below what they had anticipated, and 13 percent reported sales above expectations. Seasonal items, food, housewares, electronics, apparel, and hardware were all strong sellers, while shoes, children's apparel, and gift items were moving more slowly. Most contacts noted that inventories were at desired levels. Retailers also appear generally optimistic about sales over the next two months.

Car dealers in the District reported that, compared with last year, sales in January and February were virtually unchanged, on average. About 42 percent of the car dealers surveyed reported decreases in sales, while 38 percent reported increases. About 45 percent of the car dealers who responded noted that used car and low-end sales had increased relative to new car and high-end vehicle sales. Approximately 22 percent of the contacts reported increased use of rebates, while 65 percent reported no change. About 42 percent of car dealers reported that their inventories were too high, with a few reporting that all types of cars have been affected by excess inventories. Three-quarters of the car dealers surveyed stated that they are optimistic about increased sales during the next two months.

Manufacturing and Other Business Activity

Reports from the manufacturing sector in the period since our previous report have been mixed. A number of manufacturers reported plant openings and expansions, and slightly fewer contacts reported plant closings and cutbacks. Several small firms in the nonmetallic minerals, electrical equipment, and household appliance industries announced plans to open new plants in the District, likely resulting in more than 130 new jobs. Other firms in the aerospace, furniture, and food processing industries reported plans to expand facilities, add new production lines, and hire as many as 610 new workers. In terms of employment, these positive reports were more than counteracted by negative reports. District manufacturers reporting plans to close plants and reduce the workforce include firms in the beverage, machinery, plastics, textile mill, and fabricated metal product industries. The closings and layoffs in these industries would displace as many as 1,480 workers by early 2007.

The District's service sector continues to improve in most areas. Contacts in the utilities, airport operations, recreation, traveler accommodation, food service, transportation and warehousing, medical laboratories, and educational services sectors reported new facility openings and expansions. Other firms in the business support, computer product, and technical services sectors reported plans to add new operations and hire as many as 255

workers. For example, one firm in the freight transportation industry plans to hire 200 new workers to meet increased demand in international markets. In contrast, several contacts in the educational services and health care sectors reported plans to lay off several hundred employees.

Real Estate and Construction

In the Eighth District 2004 was another banner year for the residential real estate market. In Memphis, 2004 home sales were up 13.8 percent over 2003. In St. Louis, 2004 home sales were up 2.6 percent over 2003. In northern Kentucky, 2004 home sales were up 8.6 percent over 2003. In most of the District's metropolitan areas, except west Tennessee and the greater St. Louis area, 2004 permits were up.

Commercial real estate markets continue to lag behind residential markets in most of the District but seem to be slowly strengthening. In Louisville, from the third to fourth quarter of 2004 the overall office vacancy rate declined from 19.5 percent to 19.2 percent and the industrial market also declined from 9.8 percent to 9.2 percent. In Memphis the year-end industrial vacancy rate closed 2004 lower at 18.4 percent. Commercial construction continues to do well in the District, with several new projects in Louisville. Contacts in Memphis also predict a strong 2005.

Banking and Finance

A survey of senior loan officers at a sample of District banks indicated little change in overall lending activity in fourth quarter 2004. During this period, credit standards for commercial and industrial, commercial and residential mortgage, and consumer loans remained basically unchanged. During this period, demand for residential mortgage loans showed some indications of weakening, while demand for commercial real estate and consumer loans was unchanged.

Agriculture and Natural Resources

Recent fieldwork activity seems to have been limited as a result of muddy fields or surplus soil moisture levels. The current winter wheat crop is mostly in fair or good condition. The total value of all District field crops declined 6 percent from 2003 to 2004. Missouri was the sole District state showing an increase. The number of catfish operations and water surface acres used for production is unchanged from January 2004 in Mississippi, the nation's largest catfish producer.

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Ninth District--Minneapolis

The Ninth District economy grew moderately from mid-January through February. Growth was evident in consumer spending, manufacturing, energy, and mining. However, agriculture was steady, construction and real estate were mixed, and tourism was soft. Employment grew modestly, and wage increases were moderate. While overall price increases were modest, significant increases were noted in heavy equipment and health insurance.

Consumer Spending and Tourism

Overall retail sales increased since the last report. A major Minneapolis-based retailer reported same-store sales up 9.4 percent in January compared with a year ago. A women's clothing retailer based in Minnesota reported same-store sales up 19 percent in January from last year; however, a leather products retailer, also based in Minnesota, reported same-store

sales down 1 percent. According to respondents to a survey of district retailers in February, 44 percent expect sales revenue to increase during the first half of 2005, while 27 percent expect decreases. A Montana mall manager noted that January traffic started strong, but tapered toward the end of the month; gift certificate purchases were up over a year ago. A mall manager in South Dakota noted that sales were about even for February from a year ago after increasing slightly in January. In contrast, a Minneapolis area mall manager noted that traffic was down 10 percent in January compared with a year ago.

After strong sales during the holidays, Minnesota car and truck sales were soft in January compared with a year ago, according to a representative of an auto dealers' association. However, a Montana association representative indicated that car and truck sales were up in January and early February compared with a year ago.

Tourism conditions were soft in several parts of the district due to a lack of snow. An official in South Dakota noted slow winter tourism activity, and a Montana bank director reported slow snowmobiling activity. Meanwhile, recent spending was up 5 percent to 6 percent over a year ago in the Upper Peninsula of Michigan due to favorable snow conditions compared with neighboring areas.

Manufacturing

Manufacturing activity increased. Preliminary results from a survey of district manufacturers conducted in late January and February by the Minneapolis Fed and the Minnesota Department of Employment and Economic Development revealed that businesses expect production, productivity, and profits to increase in the first half of 2005 from a solid second half of 2004. In addition, a February survey of purchasing managers by Creighton University (Omaha, Neb.) indicated increased manufacturing activity in the Dakotas and Minnesota. In North Dakota, an equipment producer is expanding a production facility, and in South Dakota, a medical supplies maker is adding capacity at a manufacturing facility. A Minnesota food processor is expanding operations; however, a freezer factory shut down for a week to reduce inventories.

Construction and Real Estate

Commercial real estate and construction were mixed. Demand for office space in Minneapolis-St. Paul continued to grow, in particular for offices in the suburbs and downtown Minneapolis. A Minneapolis real estate firm forecast a rebound in 2005 for the metropolitan office market, and a doubling of the rate of absorption for industrial space. However, contracts awarded for large construction projects in Minnesota and the Dakotas decreased 14 percent for the three-month period ended in January compared with a year ago. A regional construction industry publication reported an uncertain forecast for the year ahead due to public funding issues.

Residential construction and real estate were down slightly. January building permits declined 23 percent in the Minneapolis-St. Paul area from a year earlier and decreased in Rochester, Minn., as well. However, construction began on a \$10.5 million senior living apartment complex in Sioux Falls, S.D. Development officials there reported a strong start to the year for residential construction, with 80 single-family housing units and 10 townhomes permitted through February. In Minneapolis-St. Paul, the number of listings on the market fell in January, and sale times continued to increase, but median sale prices were up 9.8 percent from a year earlier.

Energy and Mining

Activity in the energy and mining sectors increased. Several ethanol plants and electricity generating facilities are under construction or planned across the district. Oil and gas exploration and production were about level from early January through mid-February. Meanwhile, several mining companies submitted permits to expand or open new operations. Iron ore production was solid. A bank director noted that capital expenditures in the Montana mining sector were strong.

Agriculture

Economic activity in the agricultural sector was steady. Lenders responding to the Minneapolis Fed's fourth quarter (January) agricultural credit conditions survey expected that overall agricultural income would be flat in the first quarter of 2005, but capital spending would increase from the first quarter of 2004. The U.S. Department of Agriculture forecast firm 2005 prices for the district's main agricultural commodities--corn, soybeans, wheat, dairy and meat.

Employment, Wages and Prices

Employment grew modestly since the last report, with signs of labor market tightening in some sectors. Welders and machinists were in short supply recently in northern Minnesota as several manufacturers ramped up production to fill increased orders. According to results of the survey of district manufacturers, 38 percent expect to hire more workers during the first half of 2005; 10 percent expect decreases. In contrast, results of the survey of district retailers show that 10 percent plan to hire more workers during the first half of 2005, while 17 percent expect to decrease staff levels. In addition, the number of Minnesota job openings in the fourth quarter 2004 was about the same as in the fourth quarter 2003, according to a state survey of businesses.

Wage increases were generally moderate. Hired farm workers in Minnesota, Wisconsin, and Michigan were paid slightly less in January compared with a year earlier. Wages for district manufacturing workers recently increased over 3 percent compared with a year ago--a moderate gain, but the highest year-over-year increase since spring 2002. In contrast, a Minneapolis law firm recently raised the starting salary for associate lawyers more than 10 percent after more than four years of relatively level salaries.

While overall price increases were modest, significant increases were noted in heavy equipment and health insurance. Bank directors noted that increases in consumer prices for the three-month period ended in January were relatively modest. Agricultural, construction, mining and railroad equipment, and machinery prices posted notable increases from December to January. A bank director in Montana reported that over the past year, increases for health insurance ranged from 10 percent to 30 percent. Prices for natural gas, oriented strand board, framing lumber, and iron and steel scrap have decreased during the past few months, but remain above year-ago levels.

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Tenth District--Kansas City

The Tenth District economy expanded moderately in late January and February. Manufacturing and tourism activity increased solidly, energy activity rose from already high levels, and labor markets continued to firm. In addition, retailers reported modest gains,

home sales rose, and commercial real estate showed some improvement. On the negative side, auto sales fell slightly, and homebuilding eased. Retail price pressures remained modest. However, wholesale price pressures persisted, and wage pressures edged higher for some businesses.

Consumer Spending

Consumer spending in the district rose modestly in late January and February. Retailers and mall managers generally reported sales were up slightly from last year's solid levels. Sales of apparel were characterized as especially strong, due in part to post-holiday discounting. Store managers were generally satisfied with inventory levels, although a luxury department store plans to increase stock levels more than normal this spring due to expectations of stronger sales. Overall, retailers anticipate continued modest year-over-year sales gains in the months ahead. Motor vehicle sales fell slightly from the previous survey and were below year-ago levels throughout the district. A number of dealers noted some weakening in SUV sales, which have been particularly strong in recent years. Several dealers also reported stronger sales of used cars than new cars. Despite sluggish overall sales in recent months, most dealers were satisfied with inventory levels. Vehicle sales are generally expected to strengthen somewhat in the months ahead. Travel and tourism activity continued to improve in late January and February. Hotel occupancy rates were well above year-ago levels in the Rocky Mountain states, and airport traffic was up solidly from a year ago in most district cities.

Manufacturing

District manufacturing activity continued to expand solidly. Overall, plant managers reported increases in production, shipments, and orders compared with the previous survey, and most firms said activity was stronger than a year ago. Employment at most district plants was unchanged from the previous survey after rising steadily during the past year. A number of manufacturers reported difficulties obtaining materials, especially those transported by rail. These difficulties are generally expected to persist and possibly to worsen. Plant managers remain quite optimistic about future production and anticipate modest increases in employment and workers' hours in the months ahead.

Real Estate and Construction

Residential construction activity continued to ease, but home sales rose slightly and commercial real estate showed modest signs of improvement. Builders generally report that single-family housing starts were down slightly from the previous survey but still close to year-ago levels. The strongest starts were reported for moderately-priced homes. No difficulties were reported in procuring construction materials. Most builders expect steady construction activity in the months ahead, with starts largely matching last year's strong levels. Based on reports from real estate agents, home sales in most district cities were up slightly from the previous survey and from a year ago. As with builders, the strongest activity was reported for middle-priced homes. Sales of luxury homes were reported as weak in several cities. Heading forward, nearly all real estate agents expect continued modest increases in home sales. Mortgage lenders reported a slight uptick in demand since the previous survey, though loan demand was generally weaker than a year ago. Most lenders said home purchase mortgages were making up an increasingly large portion of their business, and several noted a continued shift away from variable rate loans. Lenders generally expect some increase in mortgage demand heading forward, driven by home purchase loans. While commercial real estate activity in the district remained weak overall, some continued small signs of improvement were evident. Absorption rates in several cities

were up from the previous survey, and vacancy rates were down from a year ago in a number of areas. Commercial real estate agents were also more optimistic about future improvements in office markets than in the previous survey.

Banking

Bankers report that loans held steady and deposits declined slightly since the last survey, causing loan-deposit ratios to edge upward. Demand rose for commercial real estate loans, edged down for home equity loans, and remained unchanged for other loan categories. A few respondents said business loan demand was lower than expected due to the cautious attitude of borrowers, but most bankers were optimistic about future loan demand. On the deposit side, money market deposit accounts and small time and savings deposits both fell slightly. Almost all respondent banks raised their prime lending rates since the last survey, and most banks also raised their consumer lending rates. Lending standards were unchanged.

Energy

District energy activity increased slightly from already high levels. The count of active oil and gas drilling rigs in the region edged up from the previous survey and was well above year-ago levels. Several contacts continued to report constraints on drilling due to labor and equipment shortages. Despite these constraints, most contacts expect continued modest expansion of drilling in the months ahead, as oil and gas prices are expected to remain high. One contact also said energy firms now expect strong drilling activity to continue for a longer period than in previous drilling booms.

Agriculture

Agricultural conditions generally remained solid in late January and February. The winter wheat crop received above average moisture in much of the district, and wheat producers are optimistic about crop conditions. Pasture conditions also improved, but most cattle producers do not expect to expand herds this year due to uncertainty about prices and concerns that the drought may not be over. Rural bankers report that rising energy costs are limiting irrigated land value gains.

Labor Markets, Wages, and Prices

Wage pressures increased modestly due to a firming labor market, and price pressures continued at the wholesale level. Labor markets showed further improvement, with hiring announcements outpacing layoffs. Most types of workers were readily available. However, many energy firms and some manufacturers reported increasing difficulties finding skilled workers, resulting in some modest increases in wage pressures in those industries. In addition, some firms were raising wages more than normal to attract or retain pharmacists, accountants, and truck drivers. Some types of computer programmers and retail workers were also reported to be in short supply, but employers were not markedly raising wages for those positions. Most retailers continued to report flat selling prices compared with the previous survey and expect little change heading forward. Builders reported further increases in some materials costs, such as for lumber and gypsum wallboard. Manufacturers also continued to report rising costs for a wide variety of materials, including petroleum-based inputs and several metals. In addition, slightly more plant managers than in previous surveys said they were passing cost increases through to customers. Heading forward, most manufacturers anticipate continued increases in materials prices and a moderate ability to pass on these costs.

Eleventh District--Dallas

Eleventh District economic activity showed signs of accelerating from early January to late February. Energy activity continued to strengthen, and some contacts at oil field service firms referred to conditions as booming. Manufacturing activity was also up, and retail sales were stronger. Reports from construction, real estate and the service sector were more mixed. There was little change in financial conditions. Agricultural conditions were favorable.

Prices

Strong demand for crude oil is keeping prices high. Crude oil prices fell below \$42 per barrel in late December but recently moved back over \$50 in late February. U.S. inventories of crude are above the five-year average. Gasoline prices have mostly moved with the price of crude inputs, and retail prices rose from \$1.82 to \$1.95 between early January and late February. Inventories of gasoline products have been helped by high levels of imports and are the highest February levels of the last five years.

Natural gas prices have stayed in a range of \$6 to \$6.50 per million Btu. Weather has not been severe enough to prevent winter inventories from building, and inventories are now 20 percent above the five-year average. Prices have not fallen, despite the strong likelihood the heating season will end with 1.2 trillion cubic feet of gas in storage. Some contacts expressed concern that storage might fill sufficiently that some summer gas production could be forced onto the open market which could lead to volatile prices.

Manufacturers continued to express concerns about rising costs for fuel, transportation and some raw materials. Some producers noted that these costs were squeezing profits, but there are more reports of manufacturers being able to pass cost increases to customers. A major exception was apparel, where prices continue to fall.

Labor Market

Labor markets remained generally slack, and there continue to be few reports of hiring. Still, conditions are uneven. There are some reports of hiring, such as for legal, accounting and food manufacturing. There are also reports of workers remaining unemployed for long periods. In Austin, workers are arriving from California in anticipation of finding work in the high-tech field.

A lack of qualified workers to support the energy industry has been reported as a significant constraint to expansion. Trained and experienced crews to work the rigs are a continuing problem. A large energy firm just announced plans to hire 1000 engineers and technical workers.

Manufacturing

Overall manufacturing activity continued to strengthen. Demand for food products was up, and contacts were increasingly optimistic about the year. Demand for apparel products has been unchanged.

Contrary to the usual seasonal lull in construction during the winter months, manufacturers of cement, clay, brick, tile and glass continued to report strong demand. Robust demand has allowed 2 to 7 percent price increases since January. The recent upswing in construction also stimulated demand for primary metal. Demand for fabricated metals has been strong over the past couple of months. Inventories of fabricated metals were reported to be high. Some

contacts say the higher inventories were in anticipation of future demand, and others cited fears of higher input prices.

High-tech manufacturing reported modest to good growth in orders. Contacts expect orders to continue at these levels, and one respondent noted that there doesn't seem to be any great new product on the horizon to stimulate a significant acceleration. Manufacturers of telecommunications equipment reported steady sales. Sales of wireless handsets have been particularly brisk, and inventories are lower than desired.

Refiner margins have slipped from high levels of the past few months to moderate in recent weeks because product prices have not kept pace with rising crude prices. Refiners that can use heavy or high sulfur crude are earning better margins than those relying on more expensive light sweet crude like West Texas Intermediate. Demand for chemicals has remained extremely strong and is outstripping capacity. Prices and profits are high for most chemical products, and significant capital expansion is expected on the Gulf Coast later this year.

Services

Reports from the service sector remained mixed over the past six weeks. Temporary staffing firms say demand growth was slower than expected. Contacts are uncertain why their clients are being cautious, but some thought it might be the result of continued cost cutting.

Demand for accounting services remained very high and increased slightly. Demand has been strong for work to support business transactions, mergers and acquisitions, seasonal tax needs and Sarbanes-Oxley regulatory requirements. Hiring continued to increase. Wages, salaries and fees are also increasing. Legal firms also reported strong demand and increased hiring, salaries and fees. Litigation activity is flat, but demand is strong to support transactions. The cost of doing business is going up for most law firms--driven by malpractice insurance, health insurance and rent.

Demand for wireless telecommunications services continued to strengthen. Contacts say employment reductions are planned as a result of mergers, and continued consolidation in telecommunications services is expected.

Airlines are still reporting difficult conditions. Demand has picked up recently, but contacts say fares are too low to cover costs because distressed carriers are pricing their product below a profitable level. Respondents say less-than-free market conditions are allowing bankrupt carriers to stay alive, and these airlines need to liquidate to help the industry become profitable. High fuel costs also remained a concern.

Rail traffic was strong in the western United States, particularly for metallic ores, crushed stone, trailers and containers. Demand for trucking has been strong, but rising costs for fuel, insurance and equipment are a concern.

Retail Sales

Retailers reported stronger sales growth over the past six weeks. While there were some areas of weakness, such as for home furnishings, contacts said that customers appear to have more liquidity. Several retailers noted that sales were stimulated by lower gasoline prices but said the recent rebound in pump prices brings some uncertainty. Inventories were in good shape. Retailers reported rising input costs, particularly for products containing petrochemicals, such as plastics. Contacts said the recent strengthening of sales was allowing

more of these cost increases to be passed on to customers. Costs and prices continued to fall for apparel, however.

Automobile sales in the District continue to be soft, down slightly from year ago levels, with inventories higher than desired. Railroads also reported moving fewer motor vehicles.

Construction and Real Estate

Construction and real estate markets were mixed. Demand for apartments was soft, and construction of apartments declined since the last Beige Book. Apartment occupancy continued to fall in Dallas and Houston, although rents appear to have stabilized, following declines through most of 2004. Austin's apartment market continues to improve, with less construction and steady demand. Existing home inventories continued to rise, but contacts said low mortgage interest rates spurred new home sales, and home construction edged up following a lull at the end of 2004.

Demand for office space has remained soft since the last Beige Book, but investor activity was still strong. Leasing activity continued to pick up slowly, but there are very deep holes to climb out of--especially in Dallas and Austin--according to respondents.

Financial Services

Contacts reported little change in financial conditions. Demand for lending was largely unchanged, with some contacts reporting a slight increase. There was a slight improvement in the overall quality of loans, and delinquencies were falling at some community banks. Foreclosures on commercial and industrial real estate loans were creeping up, however, and contacts said a lot of money is flowing into the real estate/mortgage sector--perhaps too much into retail. The financial industry reported that they are watching carefully to be sure that a real estate bubble does not form in Texas. Competition between lenders remains stiff.

Energy

Energy activity continued to strengthen, and optimism increased significantly. The U.S. rig count jumped 22 rigs during the past six weeks, including 13 rigs in Texas. Most new rigs were on land and primarily directed to natural gas. The number of rigs working in the Gulf of Mexico had weakened to only 93 but rebounded to 100 working rigs in recent weeks. Even so, activity in the Gulf remained lower than in 2000 and 2001--when the annual averages were 136 and 148 rigs, respectively.

Oil service companies reported that boom times are back for them, and they say they are finally sharing in the high prices enjoyed by producers for some time. Capacity is becoming an issue for many firms, with rigs and other services increasingly being signed up for multiple jobs to assure availability. Capacity is being added in manufacturing areas (such as oilfield tools), but activity is still being constrained by a lack of drilling crews, engineers, and many skill-sensitive service areas. Competition for these workers is heating up significantly.

Agriculture

Land preparation for spring planting moved ahead in drier parts of the District. Above-average rainfall improved soil moisture conditions and spurred growth of winter wheat but further delayed the cotton harvest and lowered the grade of the crop in West Texas. Ginning activities were active. Range and pasture conditions generally remain excellent, although there were reports of varied degree of livestock illness.

Strong global production of corn and cotton continues to push down prices for those crops.

High natural gas prices have pushed up fertilizer and irrigation costs, leading contacts to expect farmers in the Texas Panhandle to switch away from corn production to crops that require less water, such as cotton, sorghum or sunflowers. Contacts expressed concern that the proposal to limit crop subsidies on farm income will affect farmland values farmer's ability to pay loan debt. Ranchers remain anxious about plans to re-open trade of live cattle from Canada.

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Twelfth District--San Francisco

The Twelfth District economy continued to expand at a solid pace from mid-January through February. District contacts reported little change in overall price inflation, despite significant increases for selected producer prices. Upward pressure on wages and salaries remained modest overall. Employers have responded to rising costs for health insurance benefits largely by shifting some of the costs to workers but also by restraining wage growth in some cases. Retail sales mostly were stable, although sales of new automobiles slowed; service providers reported robust demand. District manufacturing activity expanded further and sales of agricultural products were strong. Home demand remained robust, and demand for commercial real estate improved. District banks reported solid loan demand and good credit quality.

Wages and Prices

District contacts reported that overall price inflation remained low in recent weeks. Prices of inputs to producers rose somewhat, notably for surface transportation services, energy and petroleum products, and a variety of construction and industrial materials, especially steel. Consumer prices generally remained stable overall, however, held down by vigorous competition among sellers and continued gains in production efficiency.

Respondents reported little change in labor market conditions. Employers in most sectors experienced little or no difficulty filling job openings. The primary exceptions were selected high-skill jobs in the construction, health-care, and media sectors and jobs in many sectors of the Hawaiian economy, which has been expanding at an unusually rapid pace of late. Wage and salary pressures remained modest in the District overall, with average annual increases mostly in the range of 3 to 4 percent. Most employers faced upward pressure on total compensation due to large ongoing increases in health benefit costs. While there were scattered reports of reduced hiring due to these cost increases, most businesses have responded in other ways: about two-thirds of those surveyed indicated that they have already shifted or plan to shift at least some of the cost increases to employees, while about one-third reported that they have reduced wage and salary growth at their firms to offset rising health-care costs. Several respondents noted slower growth in health-care costs recently, a trend they expect to continue this year.

Retail Trade and Services

Contacts reported largely stable retail sales compared with the previous survey period. Sales of retail merchandise in general were reported as "steady." However, sales of new automobiles weakened; solid sales of imported brands were offset by a dip in sales of domestic brands, due in part to a reduction in sales incentives by domestic manufacturers. Among used vehicles, relatively tight inventories held sales down somewhat and prompted price increases.

Sales of services by District providers have been strong, and they expanded further during the survey period. Demand for health-care and transportation services remained robust, and providers of high-tech services reported improved demand of late. Activity was vibrant in the travel and tourism sector. In Hawaii, domestic visitor arrivals continued at record highs. More generally, hotel occupancy and average daily room rates reportedly were stable or improved further in the District's major tourist destinations, including Southern California and the San Francisco Bay Area.

Manufacturing

District manufacturing activity expanded further from mid-January through February. Robust construction activity fueled rising demand for wall board, insulation, and other building materials, and manufacturers of these products reportedly faced significant order backlogs. Makers of machine tools reported solid demand. Among information technology products, semiconductor orders and sales have been solid and they picked up a bit in recent weeks; as in the previous survey period, capacity utilization dipped slightly but is expected to stabilize at a relatively high level in coming months. Contacts reported that conditions in the commercial aircraft sector improved slightly, as an increase in orders from Asia offset weak orders from domestic and European sources. The main exception to solid conditions in the manufacturing sector was in telecommunications, as makers of communications equipment continued to struggle with weak orders and substantial excess capacity.

Agriculture and Resource-related Industries

Conditions in District agricultural markets remained solid during the survey period. Orders and sales of agricultural goods were strong, spurred in part by foreign demand. However, District contacts reported that the tight supply of trucking and rail services and consequent rising prices have reduced the competitiveness of some District producers relative to those outside the region. Recent heavy rains in Southern California had a mixed impact on agricultural supply, damaging some crops but improving conditions for livestock grazing. In the energy sector, distribution of natural gas has been expanding rapidly in response to growth in residential housing, and producers operated at or near full capacity in recent weeks.

Real Estate and Construction

Demand for residential real estate generally remained robust, sustained in part by continued low mortgage rates. Sales of new and existing homes increased throughout the District, and home-price appreciation continued at an elevated pace in most areas. As in the previous survey period, however, in several areas the pace of home sales and price appreciation slowed somewhat from the highs reached in 2004. Continued solid demand for new homes kept overall construction activity at high levels in many areas, while rising costs for building materials prompted some contractors to raise prices. Conditions in District commercial real estate markets improved further in recent weeks. Office vacancy rates fell and rental rates increased modestly in several markets, and commercial construction activity picked up slightly in some areas.

Financial Institutions

District banking contacts reported solid overall loan demand and good credit quality. Commercial and industrial lending edged up, while demand for construction, commercial real estate, and residential loans slowed a bit in some areas but remained at high levels overall. Contacts reported ample availability of credit and noted that a competitive lending environment has narrowed margins in the banking sector.

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