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Summary of Commentary on _____

Current Economic Conditions

by Federal Reserve District

February 2001

SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICT

February 2001

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Summary*

A majority of Federal Reserve Districts reported sluggish to modest economic growth in February, while others generally reported mixed conditions. Growth was noted by Boston, New York, Richmond, Atlanta, Kansas City, Dallas, and San Francisco. Economic conditions were mixed in Philadelphia, Cleveland, Chicago, and Minneapolis, and St. Louis reported noticeably slower economic activity.

Consumer spending rose slightly in most Districts in January and February as retailers offered deep discounts on winter merchandise. Auto sales were generally steady, but below last year's rate. Manufacturing activity continued to decline in most of the nation, although in the Boston and Richmond Districts manufacturers reported improvement. Commercial real estate activity eased in most of the Districts reporting on that sector, but vacancy rates remain mostly steady and rents have been level or rising. Home building activity rose somewhat in New York, Richmond, Atlanta, Chicago, and Minneapolis, but declined in St. Louis, mainly because of bad weather. Agricultural conditions in the Richmond and Dallas Districts were adversely affected by dry weather. *Low grain prices and high costs for farm inputs have negatively affected farm finances in the major agricultural regions of the country.* Oil and gas drilling have increased in response to higher prices, but mining activity has been cut back in the wake of slackening demand for mine output. Bank lending has been sluggish except for an increase in home mortgage refinancing. Banks in some regions across the country have tightened credit standards

Although labor markets remain tight, over half of the Federal Reserve Districts—Boston, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, and San Francisco—
noted some signs of easing. Demand for manufacturing workers has been declining, and recently, demand for construction workers and information technology workers has softened. Demand remains strong for clerical workers in a variety of industries and for health care workers. Employers reported some easing in wage pressures, but they have

*Prepared at the Federal Reserve Bank of Philadelphia based on information collected before February 26, 2001. This document summarizes comments received from businesses and other contacts outside the Federal Reserve and is not a representation of the views of Federal Reserve officials.

seen increases in health benefit costs. Higher prices for energy, especially natural gas, were noted in nearly all Districts, but price pressures for many other products do not appear to have increased.

Consumer Spending

Retail sales rose modestly in a majority of Federal Reserve Districts in January and February compared with the same months last year. Increased sales of general merchandise were noted by New York, Philadelphia, Atlanta, Chicago, Minneapolis, Dallas, and San Francisco. Decreased sales were reported by Boston, Cleveland, Richmond, and Kansas City. Many District Banks noted that the sales gains were driven by extensive discounting in January to clear out winter merchandise. Sales varied among major lines of merchandise. Women's apparel sold well in New York, Cleveland, and Atlanta, but these same Districts and Kansas City indicated softness in sales of men's apparel. Cleveland reported increased sales of electronic items, and New York reported increased sales of home furnishings. In contrast, sales of home furnishings and housewares declined in Cleveland and Kansas City. Sales decreased for appliances in Chicago and jewelry in Atlanta.

Auto sales generally declined in the first two months of this year compared with last year, although several Districts reported that sales have improved from December. Auto dealers' inventories were described as high throughout the nation, and manufacturers were extending incentives to boost sales.

Tourism activity has held up in most of the Districts that reported on this sector. Richmond indicated that business was strong at ski and shore resorts. Atlanta reported increased occupancy rates at hotels in Florida as did San Francisco for hotels in California and Hawaii. Minneapolis reported solid winter tourism activity. However, Boston reported unexpectedly weak growth in tourism in New England.

Manufacturing

Manufacturing activity decreased in the first two months of the year in all Districts except Boston and Richmond, where it rose modestly, and New York and San Francisco, where conditions varied among manufacturers. Falling output among makers

of high-tech equipment and motor vehicles and parts was reported by Atlanta, Chicago, St. Louis, and Dallas. Declining output for electronic products and telecommunications equipment was reported by Minneapolis and Dallas. Production of industrial equipment and building materials was falling, according to reports from Philadelphia, Chicago, and Minneapolis. Some improvement was noted among manufacturers of pharmaceuticals and biotechnology in the Boston and San Francisco Districts. Philadelphia and San Francisco noted gains among manufacturers of food products. Atlanta reported that shipyards in the District had received increased orders for both military and civilian vessels.

Several Reserve Banks reported high inventories among the manufacturers in their Districts. Cleveland and Chicago noted excess inventories of steel. Dallas and San Francisco reported high inventories of telecommunications equipment. Kansas City indicated that inventories were above plan for most manufacturers in the District. Manufacturing firms were reported to be trimming capital spending in Boston, Philadelphia, Kansas City, and San Francisco.

Real Estate and Construction

Commercial construction activity eased in most of the Districts that reported on this sector. Declining commercial contracting was noted by Cleveland, Atlanta, St. Louis, and Kansas City; however, New York reported an increase, and public construction was up in the Cleveland and Chicago Districts. Commercial vacancy rates were generally reported to be steady, although Atlanta and Chicago noted some increases. More space has become available for sublet as Internet and high-tech firms have closed or reduced operations. Reports of such availability came from Boston, New York, Philadelphia, Kansas City, and San Francisco. Nevertheless, commercial rents have been steady to rising in most of these districts.

Reports on residential construction were generally positive. New York, Richmond, Atlanta, Minneapolis, and Dallas reported increases in home building, although gains were modest. Residential construction activity was steady in Philadelphia and Kansas City and down in St. Louis. Adverse weather was blamed for the slowdown in St. Louis.

Sales of new and existing homes continue to be fairly brisk in many regions, bolstered by lower mortgage interest rates. Richmond, Atlanta, Chicago, and St. Louis reported stepped-up home sales. Such sales were steady in the Philadelphia District, and down in the Kansas City and San Francisco Districts. New York and Philadelphia reported steady price appreciation for both new and existing homes, but Atlanta noted some price concessions by builders in its District.

Agriculture

Rising costs for farm inputs have negatively affected farm finances. Increased costs of fertilizers and pesticides were reported by Chicago, Minneapolis, Kansas City, Dallas, and San Francisco. Grain production in the Richmond District has been hurt by low soil moisture levels. Dry conditions have also reduced pasturage in the District. Agricultural production in the Dallas District has also been impaired by dry weather, but recent rains have improved prospects for the wheat crop and cattle forage. In general, grain prices remain low, but cattle prices appear to be firming.

Natural Resource Industries

Higher prices for oil and natural gas have stimulated exploration activity in the Minneapolis District and boosted the rig count in the Kansas City and Dallas Districts. Drilling has been constrained by limited availability of manpower and equipment, but Kansas City reports that new equipment will soon be in service. In contrast to oil and gas production, mining remains weak as low commodity prices and high energy costs squeeze mine profitability. Minneapolis reported recent and prospective reductions in output of lead, aluminum, copper, and iron.

Financial Services and Credit

Bank lending, other than residential mortgage refinancing, was lackluster in most Districts. Business loan demand eased in Atlanta, Chicago, St. Louis, and Kansas City. Commercial banks in the San Francisco District reported decreased demand for business loans for capital spending and plant expansion and increased demand for asset-based loans. New York, Philadelphia, and Cleveland indicated that commercial and industrial

loan demand in their Districts has been steady. Philadelphia, Richmond, and San Francisco reported that business loan demand has been restrained as firms in a variety of industries have cancelled or postponed plans to expand their operations. In particular, high-tech, telecommunication, and Internet firms have scaled back their activities.

Consumer lending decreased in Philadelphia, Atlanta, and St. Louis. Chicago noted an increase in credit card usage and outstanding balances. Mortgage lending for home purchases rose in New York and Chicago, fell in Philadelphia and Atlanta, and was steady in Kansas City. As mortgage rates have fallen, refinancing activity was reported to have picked up in New York, Cleveland, Atlanta, Chicago, St. Louis, and Kansas City.

Commercial banks in several Districts have tightened credit standards. New York, Richmond, Atlanta, St. Louis, Dallas, and San Francisco noted that banks in those Districts had tightened standards and stepped up monitoring of borrowers, especially for business loans and commercial real estate loans. Banks in the St. Louis District indicated that nonperforming loans have increased, but banks in the Atlanta and Dallas Districts reported that loan quality has been steady.

Employment and Wages

Most Reserve Banks continue to describe labor markets in their Districts as tight, but a number noted recent signs of easing. Greater availability of workers was noted by Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco. Demand for manufacturing workers fell in Cleveland, Kansas City, Chicago, and Minneapolis. Hiring of construction workers eased in Kansas City. Demand for information technology specialists declined in Boston. Demand decreased for temporary workers in a variety of industries in Boston and Chicago, although Richmond reported that the market for temporary workers there was mixed. Strong demand persists for clerical workers in many industries in New York, Cleveland, and San Francisco. Atlanta, Minneapolis, and Kansas City reported that nurses and other health care workers remain in high demand.

Employers reported some easing of wage pressures in Boston, New York, Minneapolis, and Kansas City. Employers in San Francisco have reduced or eliminated signing bonuses. Despite easing wage pressures, employee benefit costs, especially for

health insurance, continue to rise. New York, Atlanta, Minneapolis, and San Francisco indicated that businesses in their Districts are facing large increases.

Prices

Several Reserve Banks noted lower retail prices during January as stores offered deep discounts to sell winter goods. In February, retail prices were more stable. Nearly all Districts reported higher energy and natural gas prices. In most Districts, firms indicated that they have not passed higher fuel and energy costs on to their customers, but businesses in the Dallas and San Francisco Districts have been raising prices or imposing surcharges to cover the additional costs. According to reports received by Reserve Banks, price pressures have not increased for most products other than energy and petroleum-based commodities. Boston noted some increases in metals prices and New York reported higher software prices. Steel makers in the Chicago District have announced price increases.

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FIRST DISTRICT – BOSTON

The pace of economic activity is slowing in the First District but, for the most part, growth continues. Retailers cite weaker results in the past few months than before the holiday season. While a majority of contacted manufacturers report growth in sales or orders, they also cite signs of weakness. Both retailers and manufacturers say rising energy prices are raising costs, but they report very few increases in their own selling prices. Contacts in business services industries - software, information technology, and personnel supply - report slower demand than when last contacted in November. Commercial real estate respondents say markets are strong but appear to be weakening.

Retail

All retail contacts report either negative or weak sales growth during the December through mid-February period, but the timing of the slowing differs. Sellers of consumer electronics, computers, furniture, and construction materials note sales declines during the months of November and December 2000. Then in January and February, spending on consumer electronic products is said to have rebounded strongly, while sales in the other categories either stabilized or grew modestly. Upscale retail sales reportedly mirrored fluctuations in the stock market, with modest growth during December and January, but declines or no change in November and February. Despite weak results, unplanned inventory accumulation was reported only by contacts in consumer electronics and upscale retail. Contacts in the tourism sector say growth slowed unexpectedly in the November through February period.

Retail respondents are holding employment levels steady. Wages continue to rise at a 3 to 6 percent pace. Most contacts report that store prices are steady. While hotel room rates continue to rise, the rate of increase has slowed. Across the board, retailers say that higher energy costs are raising overhead, but productivity gains are holding down total costs. Looking forward, the mood of retailers has turned cautious. While all retail respondents expect weak economic growth during the first half of 2001, most say they are continuing with previously planned expansions of their operations.

Manufacturing and Related Services

The majority of First District manufacturing contacts continue to indicate that recent sales or orders are up relative to a year earlier. However, even firms that are experiencing growth note areas of weakness or are making contingency plans in case business softens. Companies whose overall revenues are falling include makers of industrial machinery and some consumer goods. One consumer products manufacturer indicates that major retailers are reducing inventories significantly even though their sales are not declining. Contacts producing aircraft components, biotech products, information products, and business services report strong growth in these markets. Respondents selling to the semiconductor industry note a recent weakening in sales, particularly for items used in cell phones, personal computers, and printers, but their overall revenues remain ahead of year-earlier levels.

Utility and transportation costs are up from a year ago, in some cases considerably. Contacts also report paying more for petroleum-based inputs, chemicals, and metals. Selling prices remain mostly flat or rising at a low single-digit rate. Many respondents indicate that they cannot raise prices for fear of losing business. Most manufacturers report little net change in U.S. employment, although one-quarter of the sample plan deep cuts. Some contacts indicate that the number of vacancies has fallen for salaried technical personnel. Based on current trends, most contacts expect this year's wage and salary increases to be on par with last year's, although some expect a slight moderation.

Capital spending plans are mixed and reflect some caution. For example, one manufacturer is putting some projects on temporary hold. Another plans to subcontract out some production in order to avoid making capital expenditures in economic uncertainty. Still others say they will focus on leveraging the capital they have, rather than incurring new costs.

Software and Information Technology Services

Most respondents in software and information technology services report slower demand than when last contacted in November. One respondent who provides custom application development software reports that large corporations are pulling orders because of fears about the economy. While a

few respondents worry that perceptions that the economy is going into a downturn will be self-confirming, all are still optimistic about the long-term potential for their companies. All of those contacted say that the labor market for technology workers is still tight, notwithstanding some softening attributable to the drop in competition from dot-coms. Wage pressures in the Boston area seem to be abating slightly.

Temporary Employment

All contacts in the temporary employment industry report a noticeable slowdown in demand since the turn of the year. Hiring has slowed most significantly in information technology (IT) and manufacturing. Demand for financial analysts, accountants, and office support seems to be holding up. Most respondents report little growth or slight declines in revenues and profit margins compared with a year ago. Some clients have instituted hiring freezes; others are canceling orders. Wage increases have slowed – most contacts report moderate to no growth. On the supply side, recruiting IT workers is said to be easier than before, but office support workers are still hard to come by. Most respondents view the recent slowdown as only a short-term phenomenon and expect their business to pick up in the spring.

Commercial Real Estate

Commercial real estate is still reported to be strong in most of New England, although signs of weakness are beginning to show. Contacts in the Boston area report that some dot-com companies have backed out of their leases or are trying to sublease their space. This has not yet led to price declines; indeed, most contacts report prices and rental rates to be “as high as ever.” However, vacancy rates in Boston have increased slightly over the past few months. New Hampshire and Rhode Island contacts report strong markets, but respondents from Maine say commercial real estate there has slowed.

SECOND DISTRICT--NEW YORK

Economic conditions in the Second District remain generally favorable, with growth continuing at a moderate pace. Cost pressures have intensified, though prices of finished goods and services continue to rise at only a modest pace. Despite weakness in the manufacturing sector and slower hiring at dotcoms, labor markets remain tight, led by hiring in the financial services sector. While some moderation is reported in wage increases, sizable increases are reported in employee health benefits. Most retailers report that same-store sales in January and February were up moderately from a year earlier, and generally on or slightly above plan, while selling prices were little changed.

Commercial and residential real estate markets remain robust, aside from some further softening in Manhattan's apartment sales and rental markets. Recent declines in housing permits and starts are attributed to harsh weather in early 2001; in general, conditions in the construction industry remain tight, with activity constrained by shortages of land and licensed trade workers. Purchasing managers report mixed conditions in the manufacturing sector in January, along with intensifying cost pressures. Finally, bankers report weaker consumer loan demand, little change in delinquency rates, and further tightening in credit standards on commercial loans and nonresidential mortgages.

Consumer Spending

Retail sales were generally on or slightly above plan in January and February. For the two months combined, same-store sales at major chains ranged from a slight decline to a 4 percent increase, compared with last year's unusually brisk sales. While January's strength was largely attributed to strong clearance sales and a catch-up to purchases deferred by harsh turn-of-the-year weather, February's strength was largely attributed to fundamental strength in demand. However, contacts note that both January and February are relatively unimportant sales months.

Spending on home furnishings and women's apparel picked up in recent weeks and was

described as fairly strong, but sales of men's and children's clothing were sluggish. More broadly, retailers report that inventories are in good shape—in some cases, a bit thin—reflecting strong clearance sales and effective inventory management. Retail contacts indicate that selling prices, merchandise costs and promotional activity were little changed from a year earlier. Retail wage increases are described as moderate, but sizable increases are reported for employee health benefits and utilities.

Construction and Real Estate

Residential and commercial real estate markets remain fairly robust across most of the District, though Manhattan's housing market appears to be retreating from the extraordinary levels seen through most of last year. Homebuilders in northern and central New Jersey report that there has been no noticeable change in demand in early 2001, with prices of both new homes and re-sales running 10-15 percent ahead of a year ago, and that they are still struggling to keep up with demand. Contacts indicate that construction activity in early 2001 has been more hampered by cold and wet weather than in recent years. They note that the other major factors constraining activity are persistent shortages of land and licensed trade workers, most notably plumbers and electricians.

In contrast, Manhattan's apartment market, which had shown persistent strength through most of last year, has shown further signs of softening in early 2001. In the co-op and condo market, while prices have not declined noticeably, sales volume has reportedly fallen, as buyers are less eager and sellers are reluctant to lower their asking price. According to one contact, the rental market has softened considerably in recent months; there has been a large increase in available rentals and some landlords are offering incentives, such as one month's free rent. However, demand for high-end rentals has remained strong, as more would-be buyers are deciding to rent.

Commercial real estate markets across the New York City area remain robust. In northern New Jersey and Manhattan, new construction and a wave of available sub-lease space (largely from dotcoms)

has been met with brisk demand, largely from financial and telecommunications firms. In Manhattan, vacancy rates have edged up but remain extremely low, while rents have risen roughly 20 percent over the past year. In northern New Jersey, leasing activity strengthened noticeably over the past year, largely fueled by firms relocating or expanding from Manhattan's tighter and pricier market. However, a wave of new construction has helped keep rent increases moderate—slightly over 6 million square feet of office space are currently under construction, up from 2.5 million at the end of 1999. New Jersey's industrial market has tightened dramatically over the past year, with vacancy rates falling and rents rising by more than a third. Much of the increase is attributed to a surge in demand from the telecommunications, wholesale distribution, and printing industries.

Other Business Activity

According to a leading New York City employment agency, there continues to be strong demand for mid- to upper-level office workers, especially those with computer and related technical skills. Demand from Internet companies has tapered off, but that is described as a small part of the market; in contrast, the financial services sector continues to hire at a brisk pace. More generally, salaries continue to rise, though at a more moderate pace than last year.

Purchasing managers report mixed conditions in the region's manufacturing sector in January, along with intensifying cost pressures. Buffalo-area purchasers report that conditions in the local manufacturing sector weakened in January, led by a widespread downturn in production activity. However, new orders continued to expand at a steady pace, employment held steady, and vendor delivery times have not quickened. Input price increases grew more widespread in January than at any time in the past four years. Rochester-area purchasing managers also report weakening business conditions and declining employment in January, but also note that vendor deliveries are increasingly late and that input price pressures have intensified. Finally, New York City area purchasers report that

manufacturing activity rebounded in January, after dipping in December. Purchasers outside manufacturing offered an increasingly negative view of recent trends but remained generally optimistic about the outlook for the year ahead. Overall price pressures were little changed in January, though there was a noticeable acceleration in the cost of architectural, cleaning and computer services, as well as computer software; further, declines in computer hardware prices were less widespread than in recent months.

Financial Developments

Loan demand was mixed over the last two months, according to the latest survey of small to medium-sized Second District banks. There was a strong pickup in demand for residential mortgages, as well as refinancings. In contrast, nearly 40 percent of bankers report that consumer loan demand weakened, while less than 20 percent report stronger demand. Demand for nonresidential mortgages and commercial credit were little changed.

On the supply side, bankers report tightening standards for nonresidential mortgages and commercial and industrial loans, but little change for consumer and home mortgage loans. Lower rates on both loans and deposits were reported across the board. Delinquency rates edged up for commercial and industrial loans but were little changed for other categories of loans.

THIRD DISTRICT – PHILADELPHIA

Third District business conditions were mixed in February. Manufacturing activity was declining. Retail sales were rising amid widespread markdowns to reduce inventories. Auto sales were steady, but off from February of last year. Bank loan volumes outstanding have been decreasing as consumer and residential real estate lending have moved down. Construction contracting continued to slip, but commercial real estate markets were firm and home sales were steady.

The outlook among the business firms contacted for this report is that overall economic activity will gradually improve in the second half of the year. Manufacturers expect an upturn by the middle of the year and modest growth thereafter. Retailers forecast a further increase in the pace of sales as the spring selling season gets under way. Auto dealers expect the sales rate to be steady for most of the year, but below last year's rate. Bankers foresee no growth in lending until business conditions improve later in the year. Real estate markets are expected to remain firm, although construction is forecasted to ease further.

MANUFACTURING

Third District manufacturers reported that falling demand for their products had continued into February from January. New orders and shipments declined for the second month in a row. Order backlogs decreased as well. The decline in business has affected almost all of the major goods-producing industries in the region. Makers of capital equipment have experienced serious declines in demand, although some manufacturers of lumber products and industrial equipment posted gains in orders. Food processing companies also reported some improvement. The high value of the dollar in relation to foreign currencies continues to be mentioned by Third District manufacturers as a constraint on their ability to counter foreign competition or expand exports. The high dollar has also prompted some firms to shift production overseas.

Manufacturers expect only very slight improvement in business conditions during the next six months. Several indicated that they expect any upturn that takes hold to be only modest. On balance, the region's manufacturers have trimmed capital spending plans for the first half of the year. Some producers of industrial and business equipment reported that their customers were also canceling or indefinitely deferring expansion plans originally scheduled for this year.

RETAIL

Retail sales in the Third District were steady in February and slightly above the year-ago rate. In general, retailers said consumer confidence appears to be holding up, although some merchants noted that consumers seem to be reining in impulse buying and nonessential purchases. Large general merchandise and specialty stores that were offering lower prices appeared to be achieving somewhat better sales than small stores. Stores have cleared out most of their inventories of winter goods by extensive discounting. Merchants expect sales to be seasonally slow in early March and pick up later in the month. Some store executives said that spring merchandise that was available in late February was selling well.

Auto dealers generally indicated that sales picked up a bit in January compared to December, but were just steady during February, and below the rate posted in February of last year. Inventories were above desired levels, and dealers were looking to continued manufacturers' incentives to reduce the oversupply. Looking ahead, dealers expect generally steady sales, but at a rate significantly below that of the past few years.

FINANCE

Total loan volume outstanding at Third District banks has slipped since the beginning of the year as a result of declines in consumer and residential real estate lending. Bankers believe households are attempting to reduce indebtedness in response to uncertainty about economic conditions and recent erosion in their personal financial positions. Business lending has been virtually flat. Bankers contacted in late February said firms are limiting their borrowing as they reduce operating rates and scale back expansion plans in response to slackening demand for their goods and services. Some

bankers said that among their business customers, manufacturers were experiencing decreasing liquidity as their inventories have increased and their accounts receivable have been taking longer to collect.

Bankers in the Third District expect overall loan volumes to be flat or to increase slightly this year. Bankers generally believe the regional economy will be nearly flat in the first half of the year, followed by modest growth beginning in the third or fourth quarter. They do not expect demand for loans to increase until the improvement in business conditions is well established.

REAL ESTATE AND CONSTRUCTION

Commercial real estate markets remain firm in most parts of the Third District. The vacancy rate for office buildings has been steady in the Philadelphia central business district and in suburban markets. Average rental rates have increased by small amounts since the fall, although rates for higher quality offices have increased more significantly. Some space has become available for sublet as a result of cutbacks in planned expansion by firms, especially those involved in Internet businesses, but the supply has not significantly affected market conditions. Demand for space for biotechnology facilities continues to be strong. Contacts in commercial real estate markets expect nearly steady vacancy rates and rents this year, although some anticipate that effective rents will ease as building owners provide more generous allowances for tenant improvements. Looking ahead, contacts in the commercial real estate industry expect construction activity this year to fall below last year's rate.

Residential real estate agents generally indicated that sales of existing homes have been steady so far this year. Homebuilders also reported that sales during January and February were steady, but down from the pace set last fall. Some real estate agents and builders noted that sales of higher priced homes have increased recently, and they attribute this to a decline in mortgage interest rates. House price appreciation has been steady for both new and existing homes. Builders indicated that the availability of labor and materials has improved compared with last year but that land has become less available and more expensive.

FOURTH DISTRICT - CLEVELAND**General Business Conditions**

Economic activity in the Fourth District remains weak overall, but the landscape is mixed, with some sectors weathering the slowdown better than others. Roughly speaking, sectors tied directly to households, such as retail sales and residential construction, appear to be holding up better than heavy industry, such as steel and capital equipment. While there have been some layoffs, mainly in manufacturing, most households have yet to feel directly the effects of the slowdown; the unemployment rate remains relatively low, and wage growth has generally continued along last year's trends.

Industrial Activity

The District's industrial producers continued to experience flat to declining demand for their products in the first two months of this year. Although heavy truck producers—one of the hardest hit groups last year—saw orders improve in January from the level averaged over the last half of 2000, contacts still expect a 30% decline in the industry's production for 2001.

A survey of metal forming manufacturers revealed that most (61%) expect their business to decline over the next three months. About a third have laid off workers or have put their plants on short time. They also reported that the number of customers who pay less promptly has increased, from 15-20% in the first half of 2000 to 39% currently.

The steel industry continues to suffer from both weak orders and over supply. Contacts do not expect steel prices to rebound this year given weak demand, high inventories, and strong competition from foreign imports. While steel producers are getting more orders than at the end of 2000, orders currently remain well below levels reached this time last year.

Consumer Spending

Some contacts reported that sales were weak through January, while others experienced modest improvement. All contacts reported that sales have picked up during the first couple weeks of February, though sales were well below those of last year at this point. Sales of women's apparel and electronics are doing well, but men's clothing and housewares are still down. All contacts expected the situation to remain unchanged through the first half of 2001 with perhaps some sales growth at the end of the year.

Over the first seven weeks of 2001, District sales of new vehicles were steady, but a little below expectations. Moreover, all area auto dealers reported that sales were up from end of last year when sales were weak. The dealers offering aggressive incentives programs reported the strongest sales. Improved weather also was credited for boosting sales over December's level. Dealers still reported that fewer customers are coming into the showrooms than in the first nine months of last year. Most dealers reported inventory positions at or in excess of 75-days of sales; levels around 60-days are typically preferred. Used vehicles sales have been surprisingly strong recently.

Labor Markets

Demand is still strong for some occupations, for example, skilled administrative assistants, low skilled clerical workers, and experienced receptionists, but not for manufacturing workers or manual labor. In response to slower sales, some stores have instituted hiring freezes and cut back store clerks' hours. The demand for temporary workers softened. All contacts reported that they received virtually no new requests for temporary workers in January, although hiring improved during the first two weeks of February. Nonetheless, demand remains well below that seen throughout most of 2000.

Organized labor contacts reported virtually no change in the rate of wage growth in current contracts, with the notable exception of the public sector. So far in the first quarter—a particularly heavy renegotiation period for public sector workers—wage growth averaged 3.8% compared to 3.5% in the last quarter of 2000.

Construction

Commercial builders throughout the District reported a decline in the demand for new construction. However, not all segments of commercial construction appear to be out of favor. Municipal governments are said to have amassed relatively large surpluses, and are still in the market for construction services. As a result, many firms that have focused on private building in the past are attempting to reorient themselves to take advantage of the public work that remains available. For similar reasons, some commercial construction firms are now said to be turning to the still robust residential market.

Residential builders are cautiously optimistic about their prospects in 2001. For the year so far, most reported steady sales. Buyers seem to see the current circumstance as a buying opportunity, in part because of lower interest rates. Homebuilders,

nevertheless, remain guarded, concerned that the current economic uncertainty could soon spill over into the sector.

Cost pressures remain muted for both commercial and residential builders. In particular, drywall costs are down, and lumber prices are at an 18-month low. Labor also appears to be more plentiful, with the labor shortages of last summer reportedly a thing of the past.

Banking and Finance

In the past six-week period, commercial loan activity was at about the same level as that experienced in the fourth quarter of 2000. The decreasing cost of funds eased the liquidity problems that were reported in our last round of calls and have also generated an increased rate of mortgage refinancing activity. Delinquency rates did not change significantly, but banks are watching more closely their customers' ability to make payments.

Trucking and Shipping

Most companies reported decreases in tonnage shipped and revenue earned since the end of 2000, anywhere in the range of 2% to 8%, but a few contacts indicated that they are even or slightly above the same period last year. Note that the year-over-year drop-off is misleadingly small—the beginning of last year was slow because Y2K worries led to overstocked inventories. Compared to the end of last year, manufacturing shipments declined substantially, particularly for steel, automotive, heavy trucks, and capital goods. Shipments of electronics and retail goods declined to a lesser extent.

FIFTH DISTRICT—RICHMOND

Overview: Economic growth in the Fifth District generally remained sluggish since our last report, though several sectors showed signs of a pickup in February. Retail sales continued to weaken in recent weeks. After several months of contraction, manufacturing shipments and new orders edged higher in February, even though backlogs and employment slipped further. At District services firms, revenues and employment rebounded in the last several weeks, although at banks, lending activity was little changed. In the real estate sector, lower mortgage rates bolstered home sales in many areas of the District, while activity in commercial real estate markets was mixed. Labor markets also were mixed—wages at retail and services firms continued to rise at a moderately strong pace, but employment levels at many District businesses dropped off. Outside of energy, prices continued to rise only modestly.

Retail: District retailers reported that seasonally-adjusted retail sales declined in January and February. Weaker consumer confidence led to softer automobile and other big-ticket sales as well as sparser shopper traffic in both months, although the declines lessened somewhat in recent weeks. In addition, auto dealers reported higher inventories. Looking ahead, however, retailers were more optimistic about sales prospects during the next six months. An executive at a large department store chain told us she was already seeing strong sales of spring merchandise and a big-box retailer in Richmond, Va., said that although customer traffic remained sluggish, shoppers were spending more per purchase in recent weeks. Turning to employment, retail establishments continued to report declines in their payrolls and moderate wage increases.

Services: District services firms reported an increase in revenues and employment in recent weeks. A contact familiar with the high-technology industry in the Washington, D.C., area said moderate expansion was underway in that sector. In contrast, a contact at a Charlotte, N.C., engineering firm told us that his company had put expansion plans on hold because of concerns about the local economy. Several services industry contacts suggested that new employees were easier to recruit and that turnover rates had dropped. High-tech employees, in particular, were reported to be less likely to leave for other jobs now. Services sector prices rose at a somewhat faster pace in recent months, and wage growth picked up.

Manufacturing: On balance, Fifth District manufacturing activity expanded slightly in February, following several months of contraction. Manufacturing shipments and new

orders edged slightly higher at many plants, though they remained weak overall. Contacts at packaging and chemical firms said that orders and shipments picked up in February and they suggested that economic conditions were improving somewhat. In contrast, a textiles manufacturer in Asheboro, N.C., reported that his company's year-to-date shipments in 2001 had dropped by 15 percent. In addition, contacts at several chemicals and primary metals industries indicated some slowing in shipments. Across the District, layoffs continued to be announced, although less frequently in the last few weeks. On the price front, soaring natural gas prices drove raw materials costs higher for many District producers. A tire manufacturer in Virginia, for example, reported that higher natural gas prices hiked his company's energy costs by over 33 percent. In labor markets, manufacturing employment weakened in recent weeks, as did the average workweek.

Finance: District loan officers generally reported that lending activity was flat in the weeks since our last report. Commercial bankers continued to cite some curtailment of businesses' expansion plans and credit needs. Several bankers noted they had become more selective in extending credit in recent weeks, particularly to companies in the textiles, construction, and health care industries. On a brighter note, a number of loan officers said that interest rate reductions in January had boosted business loan demand somewhat. On the consumer side, a banker in Rocky Mount, N.C., noted that loan demand had also picked up in the aftermath of the interest rate reductions, and he believed that additional reductions would boost loan demand further.

Real Estate: Residential realtors and homebuilders reported that lower mortgage rates and warmer than normal weather had led to a modest pickup in construction and sales in recent weeks. Realtors in Virginia and the District of Columbia were particularly upbeat; a D.C. realtor noted that his January sales "were the highest in 5 months." Sales activity, however, varied considerably across price ranges. Houses in the low-to-middle price range were reported to be selling at a faster clip than higher-priced homes—in part because tumbling stock markets had taken a toll on the wealth of upper-end home buyers. Most District homebuilders reported somewhat lower building materials costs but little change in labor costs.

Commercial realtors reported mixed leasing and construction activity in recent weeks. Realtors in the District of Columbia said that demand for office space had slowed and that there had been an increase in subletting by tenants, placing downward pressure on office

rents. Commercial realtors in Virginia and the Carolinas reported generally stronger demand for office and retail space but only modest new construction activity. Class A office space remained tight throughout the District, although some easing was cited by contacts in Raleigh, N.C., and Baltimore, Md. Commercial rents across the District were generally stable to moderately higher.

Tourism: District tourist activity remained generally strong in January and most of February. Cold weather in January facilitated snow-making and boosted attendance at ski resorts in North Carolina and Virginia. A contact at a Virginia resort said both his revenues and the number of skiers at his resort had “already surpassed last year, with three weeks still remaining in the season.” The presidential inauguration in January boosted tourism in Washington, D.C., bringing approximately 200,000 out-of-town guests to the city. Contacts at coastal resorts reported strong bookings for the period between Valentine’s Day and Presidents’ Day and expected spring bookings to surpass those of a year ago.

Temporary Employment: Contacts at District employment agencies reported that the demand for temporary workers was mixed since our last report. Several agents said that there was a lessened need for temporary employees because their local economies were slowing. A Raleigh, N.C., agent, for example, reported slack demand for all types of workers, adding that several businesses there had recently closed, resulting in a “lot of layoffs.” A Rockville, Md., agent, however, reported stronger demand for office workers in recent weeks—he expects business to strengthen further in the spring because of a new client seeking to fill about 350 positions. Wages for temporary employees were reported to be little changed since our last report.

Agriculture: Although February rainfall was more plentiful than earlier in the year, many areas of the District remain dry. North Carolina contacts said that soil moisture levels remain well below average, and many areas of Virginia were also dry, causing some producers to liquidate livestock as pasture conditions have deteriorated. Dry conditions have hampered the development of small grains in North Carolina and Virginia—poor stands of small grains may be abandoned in North Carolina and replaced with soybeans, although the most recent rainfall could salvage some fields. Hay and feed supplies were generally adequate throughout the District.

SIXTH DISTRICT – ATLANTA

Summary: The Sixth District economy continued to post only tepid growth, according to recent contacts. Merchants' sales were slightly above or equal to year-ago results. Lower mortgage rates boosted single-family construction and home sales, but commercial markets continued to slow. The manufacturing sector continued to contract. Lending activity was subdued, particularly in the auto sector. Reports from the tourism and hospitality sector were generally positive. Labor markets eased in parts of the District, and most prices remained stable.

Consumer Spending: Most District retailers reported that January sales slightly exceeded year-ago levels. However, much of the sales were clearance items left over from a disappointing Christmas. Sales results during the early part of February were down from the previous month and about equal to year-ago levels; these results were largely in line with expectations. Discount department stores again reported the best sales results. Recent strong sellers included women and children's apparel and shoes; jewelry and men's apparel sales were weak. Generally, District retailers anticipate that first-quarter sales will be similar to a year ago. Total auto sales have reportedly weakened considerably, with sales in middle Tennessee, for example, reported as the worst in some time. High gas prices were cited as hurting sales of SUVs and other large vehicles.

Construction: By most accounts, January and early February single-family home construction and sales were similar to last year's levels and up from fourth-quarter results. This recent improvement in the housing market was credited to lower mortgage rates. The most positive reports came from Florida, whereas sales were mixed across Georgia. Builders continued to report that housing inventories were in check. Contacts reported that price concessions were present in several markets, including Atlanta and Nashville. The outlook among builders and Realtors is mixed

across the region but more positive than in our last report. Atlanta, Nashville, and Orlando were characterized as renters' markets in the multifamily sector.

Commercial construction continued to slow in most of the District. Vacancy rates generally remained at low levels but have increased slightly recently in several office markets, including Atlanta, Jacksonville, and Nashville, as well as in the Nashville industrial market. Office markets in Miami remained strong. Developers and lenders are proceeding more cautiously with new projects in most areas and are requiring higher levels of pre-leasing. Overall, contacts continued to see little risk of a sizable, prolonged downturn in commercial real estate markets in the District.

Manufacturing: Factory activity continued to contract. Contacts reported a further downturn in the District's paper industry because of low demand and high natural gas prices. One large paper producer closed plants in Tupelo and Mobile and is trying to sell a plant in Natchez. Some of the largest aerospace, manufacturing, and telecommunications firms in south Florida laid off workers, citing a need to reorganize and become more efficient. High-tech firms continued to pare back operations in Atlanta. Slowing light truck and auto sales led to temporary layoffs at component supplier plants in Alabama. More positively, expansion plans for current vehicle production facilities in Alabama and Tennessee and new plants in Mississippi and Alabama remain on track. District shipyards continued to receive large military and private contracts.

Tourism and Business Travel: The outlook is still bullish for south Florida's tourism industry; room rates and occupancies there are above year-ago levels. Hoteliers are optimistic about the results for the remainder of the peak tourist season, and forward reservations are at high levels. "Snowbirds" are reportedly arriving at Alabama and north Florida beaches in record numbers this year; however, one report indicated that bookings for spring break are down from last year at some

hotels. Continued strong convention activity is expected to boost Atlanta's hotel market this year, reducing concerns about the large number of rooms added in recent years.

Finance: Loan activity remained sluggish throughout the Sixth District. Consumer and commercial loan demand was weaker than last year, with automobile loan demand especially subdued. Residential mortgage demand was described as moderately weaker, although refinancing activity continued to rebound. Financial institutions were said to have raised credit and monitoring standards for most types of loans, and asset quality remains healthy.

Wages and Prices: Labor markets appear to have loosened in some areas, but most contacts noted little change in hiring plans. Some employers reportedly cut back on temporary help and limited overtime. The recent upswing in layoffs has largely brought the job-hopping phenomenon of the last two years to an end. Information technology jobs are still going unfilled in parts of the District, but turnover has slowed down and the hype of stock options has died. The critical shortage of nurses continued, putting upward pressure on wages.

Competition and weaker demand held down prices for most sectors, with the usual exceptions. Health insurance premiums continued to rise at double-digit rates; these large medical benefit cost increases have become a problem for many employers, and more firms have restructured benefit programs or increased employee co-pays. High energy price increases continued to adversely affect regional industries except for the energy extraction sector. Fuel cost increases forced many small trucking companies into bankruptcy. High fertilizer and pesticide prices are expected to squeeze many District farmers. Several contacts noted that companies cut or held prices steady in order to secure market share in the face of slower demand.

SEVENTH DISTRICT—CHICAGO

Summary. Economic activity in the Seventh District remained slow in late January and early February, due mainly to softness in the manufacturing sector. Retail sales were stronger than most contacts expected, but spending was driven in large part by substantial price discounting. Overall construction activity remained relatively strong, despite some softening in nonresidential building. The manufacturing sector continued to contract, and most contacts did not expect to see much improvement until the second half of the year. Business lending slowed slightly in recent weeks and there were a few new reports of deteriorating loan quality. Labor markets generally remained tight, but employers were reporting greater success in finding and retaining workers. Retail price inflation generally was subdued, but there were new reports of increasing prices at the producer level. High natural gas prices continued to impact nearly all sectors, and were expected to be a disruptive influence on spring planting as the consequent high cost of nitrogen fertilizer forces Corn Belt farmers to rearrange planting priorities.

Consumer spending. Consumer spending in January and the first few weeks of February generally met most merchants' lowered expectations, with sales increases predominantly reported to be in the low single-digits. Some contacts suggested that sales were softer in the Midwest than the national average, particularly in Michigan, Indiana, and Wisconsin. Heavy promotional discounting helped work down high inventories left over from slower-than-expected holiday sales, but most contacts noted that stocks remained high. Apparel sales were stronger than many merchants expected, but appliance sales were weak. Several contacts noted that higher home heating costs and lower consumer confidence were hindering overall sales. One contact in the casual dining industry noted that business at mid-level stores remained brisk, but sales at both upper and lower-priced stores softened somewhat. One contact with a large auto group in the District, whose sales were slow last year, noted that light vehicle sales were fairly strong early in 2001, and this dealer was optimistic about prospects for the remainder of the year.

Construction/real estate. The real estate market remained relatively strong in January and the first few weeks of February, despite some softening noted on the nonresidential side. Overall nonresidential construction may have weakened slightly but was still robust, in part due to continued strength in publicly funded projects. There were limited reports that a generally softer economy was leading to an increase in vacant space in some office buildings. One contact in the Chicago area suggested that effects from the dot-com shakeout were showing up as some

companies that had been expanding rapidly were taking a “wait and see” attitude so far this year. This contact also noted an increase in the number of tenants filing for bankruptcy and, in turn, breaching lease agreements. On the residential side, builders and realtors suggested that traffic and sales activity picked up modestly in recent weeks after severe winter weather dampened sales in December. Many contacts noted that interest in entry-level homes had picked up as fixed-rate mortgage interest rates came down. Members of one statewide builders association indicated that more speculative homes were being put up than they would have anticipated late last year. Stock of new housing was in good shape and there were no reports of discernible changes in sales incentives. Many realtors continued to report a shortage of listings, although this shortage had eased modestly in some areas.

Manufacturing. The manufacturing sector continued to contract, with the slowdown evident in virtually every industry. Nationwide, light vehicle sales came in stronger-than-expected in January, driven in part by increased incentive spending, and contacts reported that these trends had continued into February. Still, manufacturers continued to scale back production to keep inventories in line with anticipated sales, which some analysts expected to weaken somewhat in coming months. A contact with one large producer of high-tech goods noted a sharp drop-off in orders, a drop-off that spilled over to smaller producers of high-tech goods and services. Year-to-date steel production was down in the region and some analysts suggested that the industry might not have hit bottom yet. Some steel producers announced price increases, but inventories built last year continued to exert downward pressure on prices of most steel products. Conditions in the heavy truck industry remained bleak, as production was running at very low levels. In addition, customers were delaying delivery of trucks already ordered, and one contact noted that these orders may be cancelled altogether if freight does not improve. Prices for gypsum wallboard were off approximately 15 percent from a year ago, and one industry analyst expected prices to come down further. Capacity utilization in the industry continued to fall and there were reports of a few older, less efficient plants closing down.

Banking/finance. Overall lending activity slowed in recent weeks, as some signs of softening appeared on the business side. A contact at one large bank reported a notable decline in business loan demand, with an actual decrease in outstanding loan volume. A few bankers suggested that overall business loan quality had decreased recently, but according to one contact most of the decline was limited to trucking, manufacturing, and other very specific industries where business conditions had softened. Another bank indicated that small business lending activity remained robust, as banks were targeting smaller companies to expand their loan

portfolios. One contact noted that small high-tech companies in the Chicago area continued to face a paucity of venture capital. On the household side, loan demand firmed up in recent weeks, particularly for new and refinanced mortgages as interest rates on fixed-rate mortgages continued to trend down. There were also some reports suggesting an increase in credit card usage. One contact noted that consumers were paying a smaller percentage of their credit card balances each month, due in large part to the financial strain caused by substantially higher home heating bills this winter. Higher energy costs also were cited as contributing to an increase in default rates on auto and home-equity loans, although this effect was expected to be transitory.

Labor markets. For the most part, labor markets remained tight in recent weeks, though there were further signs of softening demand for workers in some areas and industries. Initial unemployment claims in District states remained well above year-ago levels, with the biggest increases in Michigan and Indiana. Manufacturing workers were being affected more than others, with announced layoffs by manufacturing firms becoming more frequent in recent weeks. Staffing agencies in the region reported that demand continued to soften, with one large company noting a substantial decline in billable hours in the first two weeks of February. Despite the layoff notices, many contacts reported that furloughed workers were quickly finding new positions elsewhere. Worker shortages persisted in many areas, particularly for entry-level jobs, but many employers reported greater success in filling positions. One major freight hauling contact noted that after a few years of severe shortages, the company has had no problem finding qualified drivers after many owner-operators went out of business last year. This contact also noted that the firm had pushed through price increases, helping to offset increased fuel and unit labor costs.

Agriculture. On average, District farmland values rose less than one percent in the fourth quarter of 2000, about the same as reported for the second and third quarters, according to a survey of the District's agricultural bankers. Bankers reported that most farm debt continued to be serviced in a timely manner, despite low commodity prices. Government support payments were a major factor making this possible. A major concern facing Corn Belt farmers, as spring planting approached, was the availability and price of nitrogen fertilizers, which are derived from natural gas. With natural gas prices up sharply from a year ago, fertilizer application was expected to decline, with a consequent reduction in corn yields.

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EIGHTH DISTRICT - ST. LOUIS

Summary

With energy prices remaining high, manufacturing activity weaker and several states of severe winter weather, the pace of District economic activity has slowed noticeably. Businesses generally report little or no employment growth and slowing demand. Concerns about tight labor markets have abated lately. Residential construction is down, although low mortgage rates recently have revived home sales. Credit standards for loans, especially consumer loans, have tightened, while loan demand has weakened. Crop and livestock prices have rebounded somewhat from their lows. Timber farms suffered major damage from ice storms earlier in the season.

Manufacturing and Other Business Activity

Contacts report considerable weakening in the manufacturing sector in most areas of the District, with little or no employment growth and slowing demand. Several plants, including those in the steel and plastics industries, are closing or laying off workers to stem losses. Major automobile manufacturers have idled plants for as many as three weeks to pare unanticipated inventory gains, which have resulted from slow sales. The high-tech sector continues to experience layoffs and closings, with firms in the Memphis and St. Louis areas eliminating more than 400 jobs. Contacts note that concerns over tight labor markets have abated over the past two months, as many areas experience upticks in their unemployment rates.

High natural gas prices, coupled with cold winter weather during the past two months, are squeezing profit margins at many firms, especially in the health care and manufacturing industries. Most firms, however, have been reluctant to pass on higher costs

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to consumers and, instead, are attempting to minimize their use of natural gas, while exploring options for other sources of energy. A scattering of firms, some in the chemical industry, have reacted to higher energy prices by laying off workers to reduce costs. Contacts suggest that layoffs and plant idlings will spread if high energy prices persist. On top of cost concerns, many firms in Arkansas are still recovering from severe ice storms, which caused heavy damage and forced many to shut down temporarily.

Through it all, some industry contacts remain optimistic that demand and employment will rebound. In fact, FedEx Express has announced that it will add 1,500 jobs at its Memphis hub this summer because of its contract with the U.S. Postal Service. Contacts in Mississippi and in the Louisville area anticipate a pick-up in demand and employment growth over the next few months.

Real Estate and Construction

Severe winter weather in late 2000 bit into new residential construction strikingly. At year-end, residential permits in almost all District metropolitan areas were below their year-earlier levels, in some cases, substantially. Home sales, on the other hand, which had also been falling, have rebounded, as low mortgage rates spur new or "upgrade" buyers into the market, especially in Little Rock and Memphis. The recent pick-up in sales has helped reduce housing inventories that had been growing. Real estate agents are optimistic about home sales in the coming spring, provided that mortgage rates do not increase significantly.

Nonresidential construction has also felt the bite of bad weather. In Memphis, for example, commercial contractors report that the number of bidding opportunities has declined, which translates into projects not being booked as far in the future as usual. In Mississippi, contractors report that the number of major projects being planned, such as casinos and hotels, is waning.

Banking and Finance

Senior loan officers at District banks report that credit standards for all loan categories, except residential real estate loans, have been tightened recently, with consumer loan standards being tightened the most. Lenders have increased spreads and credit score requirements on consumer loans. At the same time, demand for all types of loans has weakened noticeably. One exception, though, is refinancings, which have picked up some steam in recent weeks as mortgage rates remain low. Bankers are noticing some uptick in nonperforming loans, and many, especially those in western Tennessee, are becoming increasingly concerned about a potential rise in personal bankruptcies because of weaker economic conditions.

Agriculture and Natural Resources

Corn and wheat prices have rebounded after bottoming out last August, while feeder cattle prices continue to rise because of ongoing increases in demand. A cotton industry contact reports that plantings this spring are expected to increase slightly, even though domestic mill use remains stagnant and exports to Mexico and Turkey are below expectations. Although an industry organization expects U.S. cotton farmers to increase acreage modestly on average, farmers in the Mid-South region plan to increase planted acreage by nearly 11 percent this year.

Ice storms in the southern part of the District severely damaged timber farms, leaving many trees unusable for lumber. To recoup some of these losses, several producers chipped the damaged timber into pulp. Demand for lumber, however, has continued to decline, as southern pine lumber mills report that orders and production in 2000 were markedly below 1999 levels.

NINTH DISTRICT--MINNEAPOLIS

Economic activity in the Ninth District is mixed. Manufacturing, mining and agriculture are in the doldrums. Consumer spending is flat and housing construction continues to grow at a slow rate. However, the energy, tourism and commercial real estate sectors continue to expand at a solid pace. Labor markets are starting to loosen, but unemployment rates remain at historically low levels, and wage increases are moderate. Overall, price increases are temperate, but costs are heating up for energy, health care and housing.

Construction and Real Estate

Commercial construction activity is solid, but some signs of slowing exist. Building contracts awarded in the Dakotas and Minnesota increased 25 percent for the three-month period ending in December compared with the same period last year. According to a recent survey of architects and engineers in Minnesota, North Dakota and South Dakota, 82 percent expect their workloads to increase or stay at the same level in 2001 compared with 88 percent in last year's survey. The retail vacancy rate in the Minneapolis-St. Paul area finished 2000 at 5.1 percent, according to a commercial real estate firm, the lowest level in six years; however, office vacancy rates remain relatively high compared with the past four years. A director from southwestern Wisconsin and a contact from North Dakota report a recent increase in the number of contractors bidding on projects.

Growth in homebuilding remains slow. Housing units authorized were up 2 percent in the district for the three-month period ending in December compared with a year earlier. Nevertheless, realtors in southwestern Wisconsin expect strong demand for homes at all price levels this year. Housing rental vacancy rates dropped to 1.5 percent in Minneapolis-St. Paul, while the apartment vacancy rate in Rochester, Minn., has recently dropped as low as 0.5 percent.

Consumer Spending and Tourism

Recent retail sales grew at a modest pace. Sales at a North Dakota mall were up 2 percent to 4 percent for January compared with last year, while sales increased about 2 percent at a Minneapolis area mall, according to mall managers. A Montana mall reports flat sales for January compared with last year. A major Minneapolis-based department store retailer noted that January same-store sales were up 2.1 percent compared with a year earlier, while a leather apparel store reported sales down 6 percent for the same period.

Businesses report solid winter tourism. Snowmobiling traffic on trails in central and northern Minnesota reached a four-year high, according to an official. A chamber of commerce representative reports more business at restaurants and lodges in northwestern Wisconsin compared with last year. Most tourism areas in the Upper Peninsula are having a good year, but not a great one, according to a tourism official. Bookings were up from a year earlier at a ski resort in Montana despite less-than-usual snowfall in the area.

Manufacturing

Manufacturing activity continued to decrease. A January purchasing manager survey by Creighton University indicated slower manufacturing activity and weak new orders in Minnesota and in South Dakota. As evidence, a Minnesota medical device manufacturer plans to phase out a manufacturing facility, a computer component company cut production, a northern Minnesota cabinet producer reduced output due to weak demand and a wood mill stopped production of wood siding for two weeks. A Minnesota electronics maker slashed production due to weak demand. A window producer will shut down a South Dakota plant and consolidate operations outside the district. In addition, an Upper Peninsula manufacturing representative reports increased energy costs as the number one concern of manufacturers.

Mining and Energy

The energy sector continued to swell, while the mining industry continued to contract. District oil and natural gas exploration remained above year-ago levels as prices for these products continue at high levels. Meanwhile, mining production is decreasing due to softening demand, high electricity costs and low commodity prices. A Montana lead smelter plans to suspend operations for six months starting in April. A Montana aluminum smelter and a copper mine remain shut down due to high electricity prices. Several Minnesota iron ore mines continued to operate below capacity; however, one large iron ore mine ramped up to full production.

Agriculture

“Higher crop input costs will happen this spring with increased costs for rent, fuel, fertilizer, chemicals, repairs and seed,” reported a South Dakota agricultural lender. Farmers’ financial condition deteriorated, based on preliminary results of the Ninth District’s first quarter (February 2001) survey of agricultural credit conditions. Loan repayments have soured, as a quarter of respondents reported below-average levels of loan repayments

compared with 15 percent a quarter ago. In addition, farm income fell, as 47 percent of respondents reported below-average farm income compared with 36 percent last quarter.

Employment, Wages and Prices

Reports of layoffs continue throughout the district. A Minneapolis-St. Paul based tool company laid off about 400 employees, while a single-propeller airplane manufacturer plans to lay off approximately 130 employees in Minnesota and North Dakota. A door and window manufacturer in northern Wisconsin gave 2,100 workers the option to work a 32-hour week or take a voluntary layoff until orders pick up. A computer company in South Dakota plans to cut 400 call center employees.

While labor markets show some signs of loosening, the district unemployment rate of 3.3 percent in December remains well below the historical average. According to a fourth quarter job survey by the state of Minnesota, job openings outnumbered unemployed persons by more than two to one in the Minneapolis-St. Paul area, with the highest demand in social services, health care, architecture and engineering. The director of a grocery store outlet in Sioux Falls, S.D., reported a larger pool of applicants than expected for 400 new positions. The number of active applicants for unemployment insurance benefits in Minnesota was about 14 percent higher in January compared with a year ago.

Wage increases were modest. In a December *St. Cloud Area Quarterly Business Report* survey, 30 percent of respondents in central Minnesota noted increases in employee compensation over the prior three months, which is down from 49 percent a year ago. Only 26 percent of respondents to a survey of manufacturers in Minnesota, Wisconsin and the Dakotas report higher wages in January compared with 59 percent a year ago.

Price increases were noted in energy, health care and housing; however, overall price increases were moderate. Natural gas prices in February were more than double a year ago, but down 13 percent from a month ago. More than half of manufacturers recently surveyed in Montana claim they plan to make major changes due to higher energy costs. Health insurance costs are up over 15 percent compared with a year ago, according to a Montana bank director. In 2000 the average price of a new home reached \$127,386 in Sioux Falls, S.D., up 7 percent compared with a year earlier. Overall price increases are moderate; 22 percent of respondents to a survey of manufacturers in Minnesota, Wisconsin and the Dakotas report higher product prices in January, down from 30 percent a year ago.

TENTH DISTRICT - KANSAS CITY

Overview. The Tenth District economy remained sluggish in January and early February. Retail sales were soft in much of the district, residential building was flat, and commercial construction edged down. Manufacturing continued to be the weakest sector, as activity declined further. On the positive side, energy activity continued to benefit from high oil and gas prices. In the farm economy, snowfall improved growing conditions for the winter wheat crop but high energy prices pushed up production costs. District labor markets remained tight, although recent layoffs appeared to have eased labor shortages somewhat. Wage pressures remained largely subdued. Retail prices edged down due to heavy discounting, while prices for petroleum-based manufacturing materials continued to rise.

Retail Sales. Retail sales in January and early February were at or below year-ago levels in much of the district. Cosmetics and electronics sold well, while sales of decorative items and men's clothing were weak. Most retailers said they expected sales to improve in the spring, although other contacts expressed concern about the shaky state of consumer confidence. Motor vehicle sales remained lower than a year ago in most parts of the district. Inventories of unsold cars continued to build, and many dealers have delayed purchasing new vehicles. However, signs of recovery were evident in some areas, which dealers attributed in part to extensive dealer incentives and favorable credit conditions. Dealers were also more optimistic than in previous surveys about sales in coming months.

Manufacturing. District factory activity fell further, with more firms reporting medium and low levels of capacity utilization than in previous surveys. Furthermore, capital expenditures at district plants were down from a year ago, and purchasing managers were less optimistic about future factory activity than in the recent past. Manufacturing materials remained generally available and lead times

were virtually unchanged. Managers do not anticipate many material availability problems in coming months. Firms continued to trim inventories but most managers were still not satisfied with current stocks and plan to trim further through the spring.

Real Estate and Construction. Residential construction activity remained subdued in January and early February, and commercial building declined slightly. Housing starts in most of the district were unchanged from December and below year-ago levels. However, some builders expect residential construction to rise more than the usual seasonal amount over the next three months. Sales of new and existing homes fell in most of the district, and inventories of unsold homes were up from a year ago. Mortgage demand rose considerably, but the increase mainly reflected the boost to refinancing activity from lower mortgage rates. Lenders expect refinancing activity to remain strong through the spring. Commercial construction activity edged lower, amid reports that uncertainty about the economy was causing some builders to become more cautious. Vacancy rates generally held steady, although cutbacks by troubled high-tech firms led to an increase in space available for sublease in one major market. Commercial realtors continued to express concern about possible overbuilding in some markets.

Banking. Bankers report that loans declined and deposits increased since the last survey, reducing loan-deposit ratios somewhat. Demand eased for all major loan categories except home mortgage loans and home equity loans, both of which were flat. On the deposit side, demand deposits, NOW accounts, and small time deposits were all up, while other categories were unchanged. All respondent banks reduced their prime lending rates, and half the banks also decreased their consumer lending rates. Most respondents said they did not expect to adjust these lending rates further in the near term. Lending standards were generally unchanged from the previous month.

Energy. District energy activity continued to rise, as energy prices remained high by historical standards. The count of active oil and gas rigs was up only slightly from the beginning of the

year, but mainly because expansion continued to be constrained by the availability of new rigs. Reports suggest that these supply constraints might ease somewhat in coming months, as several newly built rigs begin working in the district. Oil prices remained largely unchanged from December, while natural gas prices retreated but were still over twice as high as a year ago.

Agriculture. Recent snowfall replenished soil moisture and improved growing conditions for the district's winter wheat crop, which had been hurt by last autumn's dry weather. Due to the dry conditions early on, fewer wheat fields were suitable for grazing this winter, but other forages were in ample supply. High energy prices have raised fertilizer prices, pushing up production costs and encouraging producers to shift some spring plantings from corn to soybeans and other crops that require less fertilizer. District bankers indicate government payments to farmers limited deterioration in farm loan portfolios. Nevertheless, bankers remained concerned about prospects for the weak farm economy. Small business activity in rural areas remains sluggish, especially in farm-dependent communities.

Wages and Prices. While district labor markets remained tight in January and early February, numerous contacts reported seeing some signs of easing. Some manufacturing and construction workers were more readily available than in previous surveys, and recent layoffs at Internet and telecommunications firms have helped ease the extreme shortage of high-tech workers. On the other hand, the markets for entry-level and health care workers remained very tight. The proportion of business contacts reporting increased wage pressures remained lower than in recent years. However, there were some reports of improvements in benefit packages for entry-level workers. Retailers have been discounting more than in previous years, but expect prices to return to normal in the near future. Prices for petroleum-based manufacturing materials continued to rise, and some firms expect a further increase in coming months. Building material prices remained largely unchanged.

ELEVENTH DISTRICT—DALLAS

Overall Eleventh District economic activity decelerated slightly in January and February. Some industries continue to report very difficult conditions, but several others reported a mild rebound since the last beige book. Orders fell for several manufacturers, with sharp drops at some high-tech firms, but construction-related manufacturing rebounded slightly, and orders for energy-related products remained strong. Demand growth for business services continued to soften, but contacts emphasized that conditions are not dire. Retail sales rebounded in January, but year-over-year growth weakened again in February. Overall construction and real estate activity picked up slightly over the past six weeks after weakness in the fourth quarter of 2000. The financial services industry reported loan demand continued to soften, but asset quality and credit standards remained unchanged. The energy industry is still a bright spot, with continued increases in international drilling, but contacts say a lack of labor, machinery and management focus are constraining drilling activity. Rain improved agricultural conditions.

Prices. Price reports were mixed. Several industries said higher energy prices were boosting selling prices, but other industries said competition is preventing them from passing these costs on to consumers. OPEC production cutbacks boosted oil prices slightly over the past six weeks, but warming weather pushed down heating oil and natural gas prices. U.S. heating oil and natural gas inventories have increased, after falling to critical levels in late December. Heating oil inventories are now above the levels at this time last year, but natural gas inventories are still 30 percent below normal. Natural gas prices have fallen slightly but remain very high by historical standards. With 25-30 percent of U.S. ethylene production closed down, petrochemical inventories have declined and spot prices have increased, allowing producers to cover feedstock price increases. Following heavy discounting in December, retailers reported little change in selling prices in February. Most retailers said inventories are in good shape but some said they were a little lean. Price increases for single family housing have not been as strong in the first two months of 2001 as last year.

Labor Markets. Labor market conditions continued to loosen, with several contacts reporting that they are laying off, no longer hiring or having less difficulty hiring workers. A few contacts were pleased that the labor market had loosened because they had been forced to hire workers whose skills were lower quality than desired. These firms expect productivity increases as they lay off the less skilled workers.

Manufacturing. Overall manufacturing activity declined since the last beige book. High-tech firms reported a sharp drop in consumer and business demand, and contacts expect continued weakening. Contacts also noted that major global accounts are freezing IT budgets. Excess inventories do not appear to be a major concern, however. PC sales slowed again after an up-tick in January. Demand and orders for telecommunications products and services have fallen sharply over the past 60 days. Some telecom firms report higher than desired inventories. Telecom firms say they are still looking for new products and services to stimulate demand. Semiconductor manufacturers say growth in orders has declined significantly and expect sales will get worse and probably decline over the next 30 days. Semiconductor price declines have accelerated, falling 5 percent over the past 30 days. Many semiconductor contacts say inventories are lean. However, firms who do not have their own production facilities, commonly referred to as “fabless,” may be building inventories because they purchase with long-term contracts.

Slowing growth was reported in other industries as well. The national slowdown in the trucking industry has affected regional area transportation manufacturers, and some have announced layoffs. Sales of paper products have flattened, after sharp declines in the fourth quarter. Since this is not the normal seasonal pattern, paper producers expressed concern about the economy. Petrochemical producers are still operating at low levels of production although some facilities, which had been taken off line, are slowly coming back on line. Some high-cost producers had closed because operating costs were too high. Poor weather conditions and cutbacks in automobile manufacturing resulted in severe decreases in demand for clay and glass products. Other construction-related products, such as cement, concrete and lumber reported slight recoveries from fourth quarter’s lows. Inventories of these products remain fairly high, but contacts expressed few concerns because they are anticipating a reasonably strong summer.

Primary metals producers reported steady sales over the past few weeks. Demand for fabricated metal products tied to the energy sector continued to rise, with some contacts wondering how they were going to meet current demand. Refiners are enjoying good profit margins as the industry moves from production and distribution of heating oil to gasoline.

Services. Demand growth for business services softened since the last Beige Book. Temporary firms reported that business has generally softened, although not as much as nationally. Legal firms again reported slower growth and signs of a slowing economy; demand was strengthening for litigation and bankruptcy activity, while real estate, IPO, and transactional areas continued to decline. Transportation services have also experienced a modest decrease in demand. These firms continue to pass on high fuel costs to consumers.

Retail Sales. After weak unit sales in December, retailers said growth rebounded in January. While January sales were driven, in part, by discounting, most contacts said discounting was more severe in December, relative to the previous year. Sales growth cooled in February, to around 2 percent above last year for most contacts, which met expectations. Retailers believe sluggish sales are being caused mostly by weak consumer confidence, citing evidence that consumers have money to spend. They note good sales of big ticket items, no increase in bad debts and robust Valentine's Day spending, including healthy sales of singing gorillas. After declining in November and December, auto sales rose slightly in January and February, but dealers don't believe sales have hit bottom yet. Automobile inventories have been piling up for the past couple of months, and selling prices are falling despite higher input costs.

Financial Services. Contacts reported slowing loan demand, particularly at larger banks, which they attribute to slowing consumer confidence rather than economic sluggishness. Bankers reported no change in asset quality and said that there had been no recent changes in credit standards, although some said they were tighter than six months ago.

Construction and Real Estate. Overall construction and real estate activity picked up over the past six weeks after weakness in the fourth quarter of 2000. Home building picked up and continues to be the strongest segment of the industry, although the market has softened for homes that sell above \$1

million. Nonresidential activity remained soft, and contacts expressed some concern. Some telecommunication firms have cancelled big plans for leasing in the Dallas market.

Energy. Activity remained at high levels over the past 6 weeks, with the U.S. rig count peaking around 1,200 working rigs. Revenues and orders are increasing as rigs and crews undertake more complicated and risky projects, but shortages of manpower and equipment continue to be a constraint on activity. International activity is rising but remains 20 percent below the levels of the last peak in 1998. Contacts expressed concern that there is a “paralysis in decision-making” at the biggest companies because they remain tied up in mergers and have made major cuts in personnel to impress Wall Street. This appears to be restraining increases in international drilling and deep-water activity in the Gulf of Mexico, despite spectacular recent finds.

Agriculture. Rain was welcomed throughout the District. Much of the wheat crop has been stunted by dry conditions, and farmers are optimistic that warm weather will stimulate crop growth. Cotton market conditions remained sluggish, with too much supply relative to demand, depressing prices. Energy, irrigation and fertilizer costs have increased substantially, leading to a serious cost-price squeeze for many producers. Cattle producers reported improved forage conditions, reducing the need for supplemental feeding in some areas. Producers say they may be able to stop liquidating their animals and increase domestic livestock numbers, which are below normal.

TWELFTH DISTRICT — SAN FRANCISCO

Summary

Reports from contacts pointed to more modest growth in the Twelfth District economy in recent weeks and some easing of conditions in tight labor markets. Respondents reported moderate to weak retail sales so far in 2001 and mixed trends in manufacturing. The farm sector continued to be characterized by low product prices and high costs. Real estate and construction activity generally remained strong, although ongoing dot-com cutbacks have increased availability in commercial office markets in California and Washington. District respondents noted that credit markets have experienced moderate tightening in recent weeks.

Wages and Prices

Contacts indicated that the District's labor market conditions eased somewhat in recent weeks, although they remained tight in most of the large metropolitan areas. Respondents noted several factors that have contributed to the easing, including layoffs in the high-tech, Internet, and energy sectors and slower growth in labor demand in financial services. Many contacts indicated that signing bonuses and special compensation packages were either smaller or no longer necessary to attract qualified workers. Still, bonuses continued to be offered for some skilled positions such as engineers, pharmacists, construction workers, and financial service workers. Clerical, retail, and entry-level positions also remain tight in some markets.

Respondents cited a slowdown in labor market turnover and some easing of pressures on wages as evidence that labor market conditions have loosened to some extent. However, several contacts indicated that benefits costs continued to climb at double-digit rates. Respondents noted that, in general, increased wages, benefits, and most material costs could not be passed along to consumers. One exception appears to be energy costs. Several contacts in the services and

manufacturing sectors noted that higher fuel and energy prices are being passed on; surcharges on goods and services, including hikes in charges for freight deliveries and hotel rooms, have become more common in recent weeks.

Retail Trade and Services

District contacts reported moderate to weak retail sales so far this year, despite increased discounting. One indicator of softening is the weaker vehicle sales reported in Idaho and Utah, where spending by consumers on big-ticket items became more cautious and demand shifted to lower-priced vehicles. Slower sales growth rates and declining consumer confidence have caused retailers and manufacturers to increase their emphasis on controlling inventories for goods ranging from apparel to computers. One dimension of the District economy that has held up is tourism. Respondents in California and Hawaii noted that the travel and hotel industries continued to perform well, with the latter reporting high occupancy levels and rising room rates.

Manufacturing

The District manufacturing sector, including its important high-tech component, has shown mixed strength in recent months. Recent food and beverage industry sales compared favorably with 2000. Biotech and pharmaceuticals firms continued to add jobs in recent weeks, as did aerospace firms, which also reported no capacity constraints. Investment in information systems infrastructure continued to rise, and shortages of raw materials for fiber optics and data communications (DSL) persisted. However, some contacts reported slower sales growth and postponed investments in high-tech capital equipment. Cell phone sales growth was slower than expected. The growth in sales of semiconductors used in consumer products is expected to slow in the first part of 2001. Rising inventories were noted for semiconductors, computers, telecommunications equipment, and vehicles. Manufacturers' concerns about the high cost of

energy were reported in California, the Pacific Northwest, and the Intermountain states, but production disruptions have been limited.

Agriculture and Resource-Related Industries

District farmers continued to face low product prices and high costs. Commodity prices remained low, while the cost of fertilizers and insecticides rose. In addition, while some other sectors have been able to pass on high energy costs, contacts indicated that farmers cannot do so. In contrast to the weakness in the farm sector, District ranchers continued to benefit from high cattle prices and stable feed costs.

Real Estate and Construction

Real estate and construction activity remained at high levels in District states; however, increasing signs of softening in commercial real estate markets were reported. Dot-com cutbacks have increased the available supply of office space in California and Washington. Respondents noted that leasing activity in Washington had slowed dramatically in recent weeks and that rents have fallen from high levels. Strength in residential housing was reported, especially in Hawaii, although housing sales levels and appreciation rates have slowed across much of the District. Respondents cited no shortages of labor and materials for construction.

Financial Institutions

Most District contacts reported tighter credit market conditions in 2001. Contacts indicated that financial institutions have become more concerned about loan quality, with many tightening their credit standards. Respondents cited more stringent cash flow requirements for financing commercial real estate and for high-tech firms, less funding for speculative real estate projects, and more difficulty in obtaining agricultural credit. Venture capital funding also has dropped off in the District. Regarding the demand for credit, several respondents indicated that

the demand for business credit to finance capital spending and expansion plans has fallen this year. On the other hand, there were indications of continued strength in the demand for asset-based loans.