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Summary of Commentary on

Current Economic Conditions

by Federal Reserve District

June 2001

SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS BY FEDERAL RESERVE DISTRICTS

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Summary*

Most districts report that economic activity was little changed or decelerating in April and May. Retail sales and tourism have been slow to flat across the nation. Most districts report that manufacturing activity has declined or remained weak. Commercial real estate markets have softened. New construction, while still at high levels in a number of districts, appears to have leveled off. The agricultural sector has been hurt by adverse growing conditions and higher input costs. Mining activity is stagnant. The one bright spot is the continued growth in energy exploration. Labor markets continue to ease in all districts, although a shortage of workers is reported for some occupations. Wage and price increases are moderate, but significant increases are noted in energy and health care. Lending activity varies based on location and type of loan, although credit quality has slipped in many districts.

Consumer Spending

Districts report that growth in consumer spending has been lackluster. Boston reports spending at or below last year's levels. Spending in New York, Philadelphia, Minneapolis and Kansas City in May was little changed from a year ago. Richmond sees purchases slowing from earlier in the year, and Chicago reports a disappointing May after a stronger-than-expected April. Cleveland and Atlanta report modest growth, and Dallas

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* Prepared at the Federal Reserve Bank of Minneapolis and based on information collected before June 4, 2001. This document summarized comments received from business and other contacts outside the Federal Reserve System and is not a commentary on the views of Federal Reserve officials.

says consumer spending is flat or up slightly. Weather was noted by a number of districts as a contributing factor to recent slow retail sales.

Auto sales in Philadelphia are lower than last year. Auto sales fell in Kansas City, particularly for trucks and SUVs, but dealers are cautiously optimistic about summer prospects. Minneapolis reports auto sales on par with a year ago in North Dakota, but new car and truck registrations are down from last year in South Dakota. Sales for more fuel-efficient vehicles are "picking up" in Chicago. In Dallas, auto sales are increasing slowly, but year-to-date figures are still below those of 2000. Houston auto dealers report very strong auto sales in April.

Tourism is lackluster. New York reports that Manhattan's hotel occupancy rates in March and April were 10 percentage points lower than a year ago, and average room rates saw the biggest decline in eight years. Atlanta, Chicago and Dallas report slow commercial air travel. High fuel prices and consumer uncertainty appear to be restraining travel to Hawaii, Las Vegas and other high-end destinations in the San Francisco district. In contrast, Richmond reports strong Memorial Day bookings and spending.

Manufacturing

Manufacturing activity decreased or slowed in May for all the districts. Several districts report weak new orders and higher inventory levels. Boston, New York, Philadelphia, Atlanta, Minneapolis, Dallas and San Francisco report weakness in the telecommunications industry. Richmond notes declines in furniture sales. Cleveland reports high steel inventories, while San Francisco states rising inventories of semiconductors. Kansas City indicates that factory stocks are still above desired levels.

However, Chicago reports that many contacts say the worst of high inventory levels is over. St. Louis reports planned expansions of output in the high-tech, tobacco and chemical industries.

Real Estate and Construction

Commercial real estate and construction have slackened somewhat in several districts. “Softening,” “stagnant,” “weak,” “flat” and “continued to cool,” describes overall activity in most districts. Exceptions include the St. Louis district, where commercial construction is steady, and the San Francisco district, where commercial real estate markets are sound, but with signs of weakening. Nine districts report higher vacancy rates, with increased subleasing activity as company downsizing has led to more available space. Rental rates for leased space are steady to lower in parts of the Boston, New York, Philadelphia, Richmond, Atlanta and Dallas districts.

Residential construction is mixed, while home buying is generally active. Homebuilding is strong in the St. Louis district and expanding modestly in Kansas City; however, homebuilding is soft in the Chicago and Minneapolis districts. Residential real estate markets are fairly buoyant in the New York district, while recent sales increases are reported in Cleveland, Richmond, Atlanta and Minneapolis. In the Kansas City district home sales are flat, while sales have slowed in the Philadelphia, Chicago and Dallas districts. The inventory of homes on the market is low in Philadelphia, but is higher in at least parts of the Minneapolis and Kansas City districts.

Agriculture

Spring plantings are nearly complete across the nation, but difficulties persist. Weather problems are reported in Cleveland, Chicago, St. Louis, Minneapolis, Kansas City and San Francisco. In addition, pest damage is reported in the St. Louis and Dallas districts. Atlanta, Kansas City, Dallas and San Francisco note higher production costs.

Natural Resource Industries

Energy exploration activity is robust due to high prices for natural gas and oil, while mineral mining activity is sluggish. Minneapolis, Kansas City, Dallas and San Francisco report increases in the number of oil and natural gas drilling rigs. The count of active drilling rigs in the Kansas City district reached an eleven-year high. Meanwhile, the Minneapolis district reports weak iron ore, copper and aluminum activity. Iron ore shipments are down and a copper mine and an aluminum smelter remain closed.

Labor Markets

Districts report overall easing in labor market conditions, with tightness noted in some occupations. More people are looking for work, and hiring is considered easier. Information technology workers are having more difficulty finding jobs in the Boston, Cleveland, Chicago, Minneapolis and Dallas districts. Demand for temporary staffing services is soft in the Boston, Cleveland and Richmond districts. Some retailers in New York report a decrease in employee turnover. However, examples of worker shortages include nurses in Atlanta, warehouse and light industrial workers in Richmond, construction workers in Kansas City, and engineers, welders and office workers in some areas of the Dallas district.

Wages and Prices

Most districts saw only modest pressure on wages. The Boston market for all levels of tech workers "has softened dramatically" and dampened wage pressure. Atlanta says new technology workers are being offered smaller compensation packages than last year. Minneapolis sees limited growth in manufacturing wages. In Kansas City, wage pressures "were virtually nonexistent outside of the energy sector," and workers report favoring job security over higher wages. San Francisco says the easier labor market has reduced wage pressure. However, New York, Cleveland, Atlanta, Minneapolis and San Francisco say costs are rising for health care and other employee benefit items, with districts reporting examples of annual increases running as high as 20 percent.

Non-energy prices are generally reported stable. Dallas says that stiff competition, excess capacity and high inventories are keeping prices in check in telecommunications and other industries. High inventories are reportedly keeping prices down in the retail sector and in some cases pushing them lower. Retailers – particularly of high-end goods – in Boston, New York, Philadelphia, Atlanta and San Francisco report deeply discounted prices to move overstocked inventories and boost sales. Cleveland, Richmond, Atlanta, Dallas and San Francisco report that manufacturer rebates and other incentives have helped lower car and truck prices. Boston, Cleveland, Richmond, Atlanta and Dallas all report higher lumber prices.

Districts report higher energy prices across the board, with mixed consequences. Shipping costs are up in Cleveland; Dallas reports that rail transport surcharges are increasing; San Francisco says that surcharges are increasing but "price pass-throughs remained partial."

Banking and Finance

Lending activity and credit quality vary by sector and area. Deterioration in credit quality is noted in New York, Cleveland, Richmond, Chicago, Dallas and San Francisco, though not in Philadelphia. Commercial loan demand is up in New York, Philadelphia and Chicago, but down in Cleveland, Richmond, Atlanta, St. Louis, Dallas and San Francisco. Consumer loan demand is subdued in Atlanta, Chicago, St. Louis and Dallas, but mixed in Philadelphia, and up in New York, Cleveland and Kansas City.

FIRST DISTRICT – BOSTON

Conversations with business contacts in the First District had a decidedly more pessimistic tone at the end of May than in previous months. Retailers, manufacturers, temporary employment firms, and software makers report sales or revenues mostly flat or down from year-earlier levels. Contacts in commercial real estate also report softer markets.

Retail

Most retail contacts report March through May sales even with or below their year-earlier levels. Weak sectors include department stores, upscale retail, tourism, building materials, and technology products. Apparel and furniture retailers report low but positive sales growth. Because of the generally weak sales, a few contacts are accumulating unplanned inventories.

Employment levels are generally said to be holding steady, but some contacts report laying off employees. Wage growth is moderating. With one exception, retail contacts indicate that they are not raising prices; the weakest retail sectors are extensively discounting prices to move inventory. The exception is lumber prices, which are reportedly rising. Some sectors that are heavily discounting prices report eroding profit margins. Otherwise, profit margins are said to be holding steady, with productivity improvements continuing to contain overall costs despite rising energy prices.

Most contacted retailers say they are continuing with previously planned expansions of their operations. Looking forward, their mood has turned pessimistic. Retail respondents no longer believe the economy will pick up during the second half of 2001; most expect flat to negative economic growth through the remainder of the year. They are hopeful that a recovery will begin during 2002.

Manufacturing and Related Services

About two-thirds of First District manufacturing contacts report that recent sales or orders are little changed from a year earlier. Most of the remaining one-third report sizeable declines. Makers of various consumer products cite sluggish consumer spending and inventory-reduction efforts on the part of retailers. Manufacturers supplying the automotive, steel, electronics, and telecommunications industries report that business has fallen sharply. Contacts also say their revenues are being hurt by weak air traffic, both freight and passenger, and decreased exports to Asia. The only bright end-markets mentioned are pharmaceuticals, oil and gas, do-it-yourself home renovations, and some niche food products.

Respondents indicate that they are paying more for petroleum-based products, seafood, energy, and transportation, but most materials costs are flat to down. Some companies have made modest upward adjustments in selected selling prices. However, most say current market conditions make it impossible to raise prices. Customers in the retail and automotive industries, in particular, are pushing for price reductions, resulting in abnormally low margins.

About two-thirds of manufacturing respondents have major cost-cutting programs underway. Their plans include layoffs, temporary plant shutdowns, shorter work weeks, pay freezes, and sharp reductions in capital spending and inventories. Most firms that are not aggressively cutting overall costs are nevertheless reducing their labor usage through attrition or automation.

In describing the economic environment they face in coming months, manufacturers often used words such as "tough" and "difficult." The consensus is that conditions are unlikely to improve before late in the third quarter or in the fourth quarter.

Software and Information Technology Services

Almost all of the IT respondents report softening demand for their products. Companies that market to larger corporations have been hit particularly hard as their client base has frozen most of their technology spending. One firm has seen increased demand for its service maintenance division and hypothesizes that its clients are attempting to use maintenance to extend the useful lives of their earlier technology investments. Most respondents do not believe that they are losing market share, but that demand is lower throughout their industry. Generally, this leads them to be somewhat optimistic about the future, believing that demand will come back.

All of the contacts say the market for all levels of tech workers has softened dramatically. One reports being inundated with resumes from out-of-work computer engineers. As a result, wage pressure and turnover are said to be down as well. Most of the respondents are holding employment levels steady as they wait out this period of slowing demand. One responding firm has cut its work force by about 5 percent. In addition to freezing employment, about half the respondents are "clamping down on capital spending" until demand picks up.

Temporary Employment

All respondents at personnel supply firms report considerable weakening of demand since last contacted in late February. Revenues have dropped 20 percent from a year ago, on average, owing mostly to lower volume. According to one contact, "clients are able to find workers on their own, if they are hiring at all, that is." The decline in revenues is steeper for permanent placements than for contract workers. Most respondents agree that the slowdown is across the board although IT workers are having the most difficult time finding jobs. Many contacts cite unexpected layoffs, hiring freezes, or termination of contracts at client companies.

The labor market has loosened in recent months and many contacts have more candidates than jobs available – something unimaginable a year ago. Most respondents report no increase or a slight decline in wages from a year ago. Some say pressures from clients to lower prices are squeezing profit margins. Most contacts are increasing their sales force in order to sell harder.

Commercial Real Estate

Commercial real estate markets in New England continue to soften. Contacts report noticeably lower levels of activity throughout the region. The biggest change has occurred in markets that had extreme space shortages until recently, mainly downtown Boston and Cambridge. Vacancy rates have increased substantially in those markets and rents have dropped. The sublease market is more active than a year ago, and unoccupied space and very short-term occupancy have become more common. However, most contacts still consider the market to be solid, with vacancy and rental rates back to early 2000 levels. Price levels are now "reasonable" according to some. The outlook is uncertain; most contacts say it is too early to tell where the market is going.

SECOND DISTRICT--NEW YORK

The overall level of economic activity in the District remains high, led by persistent strength in housing, but soft spots in other key sectors—retailing, manufacturing, commercial real estate, and financial services—suggest a pause in growth. Cost pressures have generally eased, and inflation at the consumer level appears to have moderated. Labor markets remain fairly strong, despite reduced hiring activity from certain industries, most notably financial services. Retailers indicate that sales were generally below plan in May, with particular weakness in hot-weather merchandise; however, steep markdowns have helped to keep inventories at satisfactory levels.

Demand for both industrial and retail space remains well-maintained, but Manhattan's office and hotel markets have slackened noticeably. Housing markets across the District remain buoyant, with stable and strong conditions in and around New York City, and a pickup throughout upstate New York. Purchasing managers report some deterioration in business conditions in May, but little change in price pressures. Finally, bankers report an increase in loan demand, a modest rise in delinquency rates, and ongoing tightening in credit standards.

Consumer Spending

Most general merchandise stores report that sales were well below plan in May. Compared with a year ago, same-store sales were little changed, on balance, with as many chains indicating decreases as increases. Cool weather was cited for some but not all of the weakness. A major home-improvement retailer reports some pickup in business in May, following a sluggish March and April; however, the firm views this as a later-than-usual seasonal surge, related to weather, and is concerned about weakening in the months ahead. Another retail chain reports that its 5 percent drop in same-store sales was largely due to a more than 50 percent drop in sales of air-conditioners. Apparel sales industry-wide are described as weak, with women's clothing continuing to sell better than men's.

Most retailers report that inventories are at satisfactory levels, as heavy discounting has been effective in clearing out overstocks. A number of contacts indicate that these steep markdowns have pulled down effective sales prices below last year's levels. Some retailers note that employee turnover has declined and that wage pressures have become a bit less pronounced, but that costs of employee benefits and utilities are up sharply over the past year.

Construction and Real Estate

Residential real estate markets remain fairly buoyant across the District, though new construction has tapered off slightly. A leading New York City realtor and a major appraisal firm both report that Manhattan's co-op and condo market has stabilized in recent weeks. Sales volume, which had been described as sluggish through April, picked up in May, and selling prices, though off their recent peaks, remain well ahead of a year ago. Separately, while rents on Manhattan apartments have reportedly leveled off in recent months, rents in some adjacent parts of the outer boroughs are reported to be up 10-20 percent from a year ago. In contrast, summer rental markets in the upscale Hamptons are reported to be noticeably more slack than last year—rental rates are flat to lower, and the number of available units is up sharply.

Based on a repeat-sales index, prices of existing single-family homes rose noticeably in the first quarter throughout the District. Double-digit increases (compared with a year earlier) persisted throughout New York City, Long Island, and the lower Hudson Valley, while price increases ranged from 7 to 12 percent across northern New Jersey. The average price jumped 6 percent in the Buffalo and Rochester areas, with comparable increases reported across most of upstate New York. More recently, Rochester-area realtors report that strong market conditions persisted in April and May, with low inventories and brisk demand prompting overbids on some higher-end properties.

Year-to-date, multi-family housing permits are roughly on par with 2000, which was the strongest year since the mid-1980s. Most of the increase reflects a surge in construction in New York City. Homebuilders in northern New Jersey describe the housing market as having a "vibrant tone", reflecting continued excess demand for both new and existing homes.

New York City's office market continued to slacken in April. Availability rates in all three of Manhattan's major markets rose another 0.5 percentage points from March. Rates rose to 5.5 percent in Midtown and to 5.6 percent in Downtown—both one-year highs—and to 7.8 percent in Midtown South (which includes much of "Silicon Alley"), its highest level since 1997. However, availability rates are still low by historical standards. Asking rents have recently declined in all three areas, though they are still up more than 20 percent from a year ago. Retail rents in Manhattan rose slightly between September 2000 and March 2001, while the amount of prime space available for rent declined, according to an industry survey. Separately, industrial vacancy rates in northern New Jersey have risen in recent months, while rents have leveled off; while demand and leasing activity are still described as relatively strong, supply has increased substantially, with approximately 2.5 million square feet of warehouse space completed in the first quarter alone.

Other Business Activity

According to a leading on-line recruitment firm, the pharmaceutical, biotech, construction and restaurant industries are still generating strong labor demand; however, a sharp reduction is reported in job postings from financial services, advertising, telecom, and high-tech companies. Separately, an New York City employment agency specializing in mid-level office workers reports that this year's college graduates are not seeing the same kind of "feeding frenzy" as last year's, but notes that a hiring freeze across much of the financial sector is giving firms in other industries an opportunity to fill open positions. A Rochester-area contact notes that, despite ongoing layoffs at some major local multinationals, a variety of technology and related firms are looking to hire more staff.

Manhattan's hotel occupancy rate averaged 78 percent in both March and April—10 percentage points lower than a year earlier. Moreover, the average room rate slipped 2.5 percent below year-earlier levels in April—the steepest 12-month decline since 1993. Moreover, higher-priced hotels generally registered steeper declines in both occupancy rates and room rates than lower-budget establishments.

In the manufacturing sector, purchasing managers report further weakening in business activity in May, and little change in price pressures. Buffalo-area purchasers report that conditions in the local manufacturing sector weakened slightly in May. While new orders rose slightly, production activity and employment levels edged down, and vendor deliveries were slightly faster (typically a sign of slackening demand). Moderate upward price pressures continued, but they were no more widespread than in April. Manufacturers and other purchasers in the New York City area report that business conditions weakened slightly in May. Input prices were reported to be flat, on balance, though a fair amount of dispersion of price increases and declines was noted.

Financial Developments

The latest survey of regional banks shows a pickup in demand for all major categories of loans over the past two months. In particular, over two-thirds of the bankers surveyed report increased demand for residential mortgages, and three out of four indicate increased refinancing activity.

On the supply side, bankers report tightening standards for all types of loans—particularly in the commercial and industrial category, where more than 20 percent report tighter credit, while only 3 percent indicate easier standards. Both loan rates and deposit rates fell according to an overwhelming majority of bankers. Delinquency rates on all types of loans edged up, on balance, since the last report.

THIRD DISTRICT – PHILADELPHIA

Overall business conditions in the Third District continued to be soft in May. Manufacturers reported further declines in orders and working hours. General merchandise sales were flat compared with April and with May of last year. Auto sales in May were below the same month last year. Bank loan volumes rose moderately during the month. Residential real estate sales slipped, and commercial leasing activity continued to decline.

Businesses contacted for this report generally expect growth to resume sometime during the second half of the year, albeit at a slow pace. Manufacturers expect an increase in orders within the next six months, but they do not plan to extend working hours. Retailers anticipate a slow summer followed by a slight pickup in sales in the fall. Bankers anticipate slight gains in business and consumer lending, but they expect the demand for real estate loans to ease.

MANUFACTURING

Third District manufacturing activity continued to decline in May. Although shipments were about steady, the region's manufacturers saw a drop in new orders. The falloff in orders was slight for most firms, but relatively large declines in demand were noted by several producers of transportation equipment, industrial machinery, and industrial materials. Firms that supply the telecommunications industry with a variety of products generally reported weak demand from that sector. Overall, manufacturers trimmed working hours and reduced employment. Although capital spending plans at area plants call for stepped-up outlays in the second half of the year, on balance the increase will be slight.

Manufacturers indicated that, except for fuels and electricity, prices were steady in May. Firms contacted during the month indicated that slow demand and foreign competition were keeping most input and output prices in check. But rising fuel prices were cited by many firms as a deterrent to expanded sales, especially of motor vehicles and construction equipment.

Manufacturers expect business conditions to improve during the next six months. Firms in nearly all of the major manufacturing sectors in the region forecast higher demand for their products in the second half of the year. The exceptions are apparel producers, who anticipate a drop in orders, and producers of chemicals, transportation equipment, and industrial materials, who expect steady order rates. Despite the forecasted increase in business, area manufacturers project no rise in order backlogs, and they do not plan to extend working hours during the next six months.

RETAIL

Retail sales in the Third District were virtually flat during May. Sales were also level compared with last year. Although sales rose slightly at some discount stores, sales at other types of stores were off. Merchants indicated that a period of cool, wet weather hampered sales of summer clothes and other seasonal merchandise. Sales of big-ticket items have been slow, as well. Retailers generally reported continuing low levels of store traffic and spending per shopper. Many stores have stepped up discounting to boost sales.

Store executives generally anticipate a slow summer. Most of those contacted for this report expect a slight pickup in the fall, and they have planned their purchasing accordingly. However, several store executives said they are prepared to cut or cancel orders if sales do not turn up.

Auto dealers indicated that sales ran at a nearly steady pace during May but below the rate posted in May of last year. Manufacturers' incentives remain extensive, and dealers said that rebates and low-cost financing were necessary to keep sales from slipping further.

FINANCE

Total loan volume outstanding at Third District banks rose moderately in May. Bank lending officers said most of the growth has been in credit card loans and residential mortgages. Other types of consumer lending, such as auto loans and home improvement loans, have declined. Mortgage refinancing activity has been strong, but most of the bankers contacted for this report said demand for refinancing has begun to ease. Growth in commercial and industrial lending has been slight, although some bankers noted a recent pickup in business loan demand, mainly from existing customers.

Bankers in the Third District expect overall loan volumes to increase slightly during the second half of the year. They anticipate slow growth in business lending and modest gains in consumer loans, but a decline in residential mortgage activity. Some bankers expressed concern that credit quality could slip during the rest of the year if overall economic conditions do not improve, but they do not anticipate a significant deterioration in either business or consumer loan portfolios.

REAL ESTATE AND CONSTRUCTION

There has been some softening in Third District commercial real estate markets in the past two months. The vacancy rate for office buildings has been steady in the Philadelphia central business district, but the vacancy rate has moved up in some suburban markets. An increasing amount of space in these markets has been offered for sublease by Internet-related firms. Average quoted rental rates in the region have been steady, but landlord allowances have increased, reducing effective rental costs. However, this decrease in rents is being partially offset by some landlords who are charging new tenants for electricity instead of including this expense in rental charges. Demand for industrial space has eased somewhat, but rental rates have been steady. Commercial construction activity has been decreasing, and sales and leasing activity have eased. Contacts in the region's commercial real estate sector expect markets to remain slow for the rest of the year.

Residential real estate agents generally indicated that sales of existing homes have slowed recently. Homebuilders reported that sales declined during May. For both existing and new homes, the slowdown has been sharper in the higher price ranges. House prices have been close to steady for both new and existing homes. Real estate agents and builders indicated that the inventory of homes for sale has been running close to or a little below demand. Due to the relatively tight inventory, homes have been selling quickly and at asking prices.

FOURTH DISTRICT - CLEVELAND

General Business Conditions

Economic activity in the Fourth District changed little in April and May as conditions remained weak. Commercial construction was, if anything, weaker than in the first quarter. Residential construction remains strong, although it has cooled slightly, possibly because of seasonal factors. Demand for steel and other manufactured goods has yet to recover. Layoffs continued, and wage growth slowed further. The persistence of the slowdown in manufacturing caused some contacts to alter their outlook; they now believe that their orders are unlikely to rebound as early or as quickly as they had forecast in March. Nonetheless, retailers reported moderate sales growth.

Industrial Activity

In general, manufacturers continued to see weak orders. Managers are eagerly looking for convincing signs of an upturn, and the downturn has made them extremely keen to trim costs to the bone and become ever more cost efficient. Manufacturers still believe that orders will rebound later in the year, but some now feel that the recovery will be later and slower than they had expected. Despite this, they remained reluctant to lay off skilled workers. A supplier of investment goods reported that year-to-date orders are about 10 percent below the same period last year. The primary reason cited was that customers were waiting for their orders to rebound.

The steel industry continued to see little improvement. Inventory levels remained high at steel service centers, and some mills are being closed temporarily. Demand for flat-rolled steel products was soft in May, with both prices and production levels low. While some observers believe that steel prices have hit bottom because they stabilized in April, others expect prices and demand to decline further in the third quarter. As in the first quarter, specialty steel makers reported a healthy demand for their products.

Consumer Spending

Retail contacts reported moderate sales growth in April and May. Apparel retailers had an unexpectedly strong April, which they attributed to good weather. In contrast, apparel sales in the first three weeks of May were weaker than expected because cool and rainy weather appears to have postponed summer purchases.

Computer, stereo, and appliance sales are still slow. One contact reported that the demand for computers, stereos, home appliances, and televisions was extremely low. Another reported seeing virtually no replacement of large-ticket items. The bright spots for these retailers have been new technical gadgets like digital cameras and personal digital assistants (PDAs), which are selling very well.

Auto sales in April and May were reportedly up significantly from earlier in the year, but they remained roughly the same as they were last year at this time. However, sales have been quite spotty, with some dealers performing much better than others. Sales of trucks and SUVs have been slightly weaker than autos but have followed approximately the same trends as car sales. Some of this difference could be seasonal, as sales of trucks and SUVs generally pick up in the summer, but higher gas prices are thought to be playing a role. Contacts related that sales continued to be dependent on dealer incentives. Sales expectations for the summer are cautiously optimistic.

Labor Markets

Union contracts negotiated in April and May contained annual wage increases of about 3.2 percent as opposed to the 3.5 percent averaged in first quarter contracts. However, health care costs are rising rapidly for many employers, and some union leaders have tried to educate members on the nature and magnitude of health care cost increases. One contact indicated health care costs increased 12 to 18 percent over the last year.

Demand for temporary labor continues to be soft. An exception is still skilled administrative workers, although most contacts believed this is due to a small pool of available labor rather than increasing demand for these workers. For most other occupations, contacts reported an increase in people looking for work. In particular, one contact observed an increase in the supply of skilled, high-tech and engineering workers. Some have been laid off from a previous job, while others are graduating from college and have yet to find full-time work.

Construction

Conditions in the commercial building sector are still characterized as stagnant. The level of new inquiries, according to one builder, remained distressingly low.

Moreover, vacancies for all categories of commercial building have continued to climb since the end of last year.

In contrast, Fourth District homebuilders continued to be in a much better position as their sales have been solid. However, although customer traffic has been good, it has been trending down over the course of the last couple of months. While this decline has been roughly consistent with normal seasonal patterns, builders are nevertheless concerned about their prospects for the months ahead.

Lumber prices have risen about 20 percent since the middle of April because of a trade dispute between Canada and the United States that may result in retroactive American tariffs on Canadian lumber. Most other materials prices, however, remain flat.

Banking and Finance

Banks in the Fourth District indicated that loan activity picked up slightly from March to May. More consumers refinanced their debt obligations to take advantage of lower rates. Many converted uncollateralized loans to home equity lines of credit to obtain a lower rate and a tax deduction. Although refinancing activity has slowed since the peak in February and March, the level was still described as high.

In contrast, there has been very little refinancing in commercial loans because commercial loan contracts frequently do not allow companies to pay off these loans early. Contacts noted that new commercial loans have been used to upgrade or repair equipment—few loans were thought to be for new investment.

All contacts agreed that the credit quality of loan applicants declined in April and May, particularly for consumer loans. Consequently, contacts reported that they plan to tighten standards or at least not loosen them.

Trucking and Shipping

Overall trucking and shipping performance was still off last year's pace, and most companies have reduced their capital expenditures. Shipping of automotive, heavy capital goods, and truck parts remained significantly down. Electronics, high-tech, and retail goods have been off somewhat as well. Shipments of refrigerated goods and food products remained strong.

Shipping costs have been going up, led by fuel prices that have recently risen to nearly last year's peak levels. Even more worrisome than fuel costs have been insurance costs, which are up about 20 percent from last year, with further increases expected later in the year. The consensus outlook among shippers was that the summer will remain slow but that there would be a rebound later in the year.

Agriculture

The good news from farmers is that nitrogen prices appear to have peaked and output prices are generally acceptable. In particular, milk prices in May were up 5 percent from March and up almost 20 percent from April 2000. Although the spring planting went very well, Fourth District fields may be receiving too much rain. Farmers are beginning to worry that they may have to replant some crops.

FIFTH DISTRICT–RICHMOND

Overview: The Fifth District economy grew slightly since our last report, as growth in services and housing was offset by weakness in retail and manufacturing. Wet and cool weather along with softening consumer confidence hindered retail sales during May. Revenue growth at services firms outside of retail, however, rose at a moderate rate in recent weeks. Manufacturing shipments and new orders were off sharply in both April and May, particularly in the apparel and furniture industries. Low mortgage rates continued to bolster home sales and refinancing activity, and growth in commercial real estate activity was more modest. Price increases were generally contained in all sectors of the District economy. In agriculture, widespread rainfall in late May benefited crops and pastures in most areas of the District, but dry conditions continued to hamper planting activity in South Carolina.

Retail: District retailers reported that their revenues declined in recent weeks. Retailers in Raleigh, N.C., and Charleston, W.V., said that rainy, cooler-than-normal weather trimmed sales in May. A manager at a large department store in the Research Triangle area of North Carolina noted that several large layoffs in the region contributed to falling sales in recent weeks. Automobile dealers reported some improvement in customer traffic, and noted that sales were generally solid, driven in part by manufacturer rebates. Lumber brokers and building materials suppliers reported increased revenues; partly because of higher lumber prices. Retail employment slipped in May and several District retailers said they would hire fewer summer employees this year because of lower anticipated sales. Retail prices continued to rise at a modest price at District stores.

Services: Services businesses across the District generally reported moderate increases in revenues in May. Despite the strength, tighter federal government budgets and the shakeout of dot-com businesses have slowed revenue growth in some areas. A contact at a website design company in West Virginia said that business had been "a little flat" because potential clients had been frightened by news of dot-com business failures. Employment in the sector rose at a relatively strong rate as did wages. District services prices rose modestly.

Manufacturing: The District's manufacturing sector weakened further in May as shipments and new orders tumbled. Declines in manufacturing shipments intensified in recent weeks, particularly for transportation equipment, fabricated metals, printing, apparel, and furniture firms. Furniture producers cited weak consumer confidence as the primary factor contributing to poor sales. A manager at a furniture manufacturing plant in North Carolina said that his shipments were falling and he expected the decline to persist during the next six months. Several apparel producers in North Carolina noted that higher energy prices continued to squeeze their profit margins; they also cited competition from abroad and a strong dollar as ongoing concerns. Employment levels in manufacturing fell further in May, while wage levels were little changed. Manufacturers reported that their prices were generally unchanged.

Finance: District loan officers indicated that lending activity was generally flat in recent weeks. Residential mortgage lending continued strong, bolstered by brisk refinancing activity. However, commercial lending was slowed by sluggish economic conditions. A Charleston, S.C., banker noted that his commercial loan officers "were not exactly being overwhelmed with new requests for loans" while a Norfolk, Va., counterpart said that he was getting plenty of calls from prospective business borrowers, but "closing fewer deals." Lenders were keeping a closer eye on the financial conditions of borrowers in cyclical industries whose financial conditions were weakening.

Real Estate: Residential realtors and homebuilders reported that home sales picked up in May. Contacts indicated that the low-to-middle priced home market remained the most vibrant, boosted by continued low mortgage rates, which have made housing affordable for first-time homebuyers. A realtor in North Carolina reported steady home sales in Raleigh and Charlotte, but indicated that some markets were now becoming "saturated" with homes. Home sales in Greensboro, N.C., were somewhat sluggish, in part because of the uncertainty surrounding the effect of banking industry mergers on the local economy. Most homebuilders reported higher prices for lumber and insulation, but little change in labor costs.

Commercial realtors across the District reported moderately weaker growth in leasing and construction activity in recent weeks. Leasing of office space was generally slower. In Northern Virginia and the District of Columbia, large blocks of office space continued to flood the market in the wake of the "high-tech fallout." Realtors in Charlotte, N.C., reported softer industrial leasing activity and an increase in available industrial space for subleasing. Most contacts reported that rents charged for office space had declined in recent weeks, while rents for retail and industrial space were essentially flat. Commercial construction activity slowed; few speculative projects were underway.

Tourism: Tourism remained strong in recent weeks. A manager of a chain of hotels in the Virginia Beach area said that his Memorial Day weekend business was better than last year, despite some rainy weather during the holiday. A hotelier on the Outer Banks of North Carolina also reported stronger Memorial Day business this year. Tourism in Myrtle Beach, S.C., was boosted by two motorcycle rallies, which attracted over 375,000 bikers during the last two weeks of May. Contacts at District restaurant and recreational facilities noted that consumers were spending freely, despite higher gasoline prices and slower economic growth.

Temporary Employment: Contacts at District employment agencies reported somewhat weaker demand for workers in the weeks since our last report. An agency manager in Cary, N.C., said that business was "at a standstill" while a Charlotte, N.C., contact was hoping the economy would soon "get out of this slump" so that business would start to grow again. Despite overall weaker demand for temporary workers, several contacts noted relatively strong demand for warehouse and light industrial workers. Wage offers to temporary workers changed little since our last report.

Agriculture: Abundant rainfall in late May replenished depleted soil moisture levels and improved crop conditions across much of the District. Although heavy rainfall hampered field preparation efforts in Virginia and West Virginia, planting activity was reported to be generally on schedule. Not all areas, however, benefited from the rainfall–dry soil conditions persisted in South Carolina and planting activity there was behind schedule as soil moisture levels remained too low for seed germination.

SIXTH DISTRICT - ATLANTA

Summary: Reports from around the District suggested that the overall pace of economic activity remained sluggish in May. The manufacturing sector continued to contract, and this has contributed to further loosening in District labor markets and an easing in wage pressures. Retailers reported modest sales growth and the continued use of aggressive pricing strategies. New automobile sales have been soft, particularly in the light truck segment. Buoyed by strength in Florida markets, the District's single-family residential market remained robust. In contrast, commercial real estate markets were mostly weaker. Demand for consumer loans eased slightly, but mortgage activity continued to be strong. Reports on the tourism and hospitality industry were cautiously optimistic.

Consumer Spending: Retailers continued to report that sales growth has been modest at best, although most indicated that inventories were balanced. Among May's strongest sellers were seasonal clothing items and some home-related products. Sales of luxury items remained weak. Overall, merchants anticipated only modest sales growth through the end of the second quarter despite the continued use of aggressive pricing strategies.

Automobile sales during April and May have generally disappointed District dealers, but with some variation across product lines. Price discounting and sales promotions remained in force. Reports indicated that inventories of some light trucks were higher than normal.

Construction: The District's single-family market improved modestly in May, but remained flat overall compared with a year ago. In south Florida, very strong demand coupled with low inventories contributed to continued price escalation. District industry contacts anticipated little overall increase in pace of sales and construction over the next few months, and expected some softness in higher price segments of the market.

At the same time, commercial real estate markets continued to experience weaker demand. In some locations a surplus of sublease space has emerged, and some new buildings have been completed without tenants in place. This has resulted in increased vacancy rates and notable price reductions. Developers and lenders have reportedly become increasingly cautious about new office and industrial development, and several new retail projects have been delayed or put on hold. Similarly, District multifamily development has slowed significantly as vacancy rates have increased in several locations.

Manufacturing: The factory sector continued to contract in May. Excess inventories remained a problem for many District manufacturers. Expansion and hiring plans have been put on hold in several industries, although the pace of layoffs appears to have slowed during May. Reports showed continuing problems in the textile and paper industries because of reduced demand and foreign competition, whereas Petro-chemical companies in Louisiana have been hurt by high natural gas prices. A producer of capital equipment said that new orders have fallen sharply from last year. A large telecommunications company has announced layoffs, and a car manufacturer reported plans to slow production and has eliminated overtime. A producer of household appliances also noted a reduced workweek and some layoffs. Activity in the oil and natural gas industry remained robust, and recent lumber price increases have benefited ailing lumber firms.

Tourism and Business Travel: Reports about the tourism and hospitality industry remained positive, but were a little less upbeat than in recent reports. In south Florida, bookings for the summer tourist season were off to a slower start than last year. Reported overcapacity in the cruise industry has led to substantial discounting in order to attract customers. Some Florida contacts were concerned that high gasoline prices would slow tourism in their area, and the strength of the dollar may be slowing the flow of European tourists. Tourist activity along the Mississippi Gulf Coast was slower than last year, but the outlook in New Orleans remained very positive. A decline in commercial air travel continued to be reported in most locations.

Financial: Loan activity varied by sector and location. Consumer loan activity eased slightly and financial institutions noted some tightening in approval standards. However, mortgage lending and refinancing continued to be strong in most of the District during May. In contrast, commercial lending remained subdued and few large commercial deals were reported.

Wages and Prices: Labor markets continued to loosen in May, and wage pressures eased. Some contacts reported that it was easier to hire labor than it was six months ago. However, there remained a severe shortage of nurses in the region, and a new initiative has been implemented by some District hospitals to hire nurses from abroad. Reports noted that new employees in technology firms were being offered smaller compensation packages than last year.

No significant general price escalation was reported. However, the price of lumber increased in May as suppliers to the construction industry worked to build up depleted inventories and as some foreign competition eased. Natural gas prices remained elevated, and contacts again reported increased health care costs.

Agriculture: Market conditions have been mixed in the agricultural sector. Farmers in Georgia and Florida noted that low crop prices and higher production costs have hurt profits compared with last year. On a more positive note, the District's large poultry industry has benefited by increased export shipments as consumers in many parts of Europe have shifted away from red meat consumption.

SEVENTH DISTRICT—CHICAGO

Summary. Economic activity in the Seventh District slowed further in May, but contacts in some key factory segments were optimistic that the worst was over. Following a modest pickup in April, consumer spending softened in May, partly as a result of unseasonably cool weather. Construction and real estate activity was also modestly weaker, but remained generally strong. The region's manufacturers continued to work off excess inventories, with most contacts confident that conditions had bottomed. The District's labor markets slackened further in April and May, and recent college graduates were finding the job market far less accommodating than last year. Farmland values continued to increase in the first quarter of the year. Spring planting neared completion although wet soil conditions have hampered progress in portions of Iowa and Wisconsin. In general, signs of any pickup in price inflation were absent from contact reports.

Consumer spending. Consumer spending softened somewhat in May after slightly stronger-than-expected results in April. Retailers generally reported that sales results in the District were falling short of their lowered expectations in recent weeks. Some were quick to point out that unseasonably cool weather had adversely affected sales results, particularly for seasonal items and apparel. One contact, citing continued strong sales of big-ticket appliances and home-related items, suggested that consumers weren't "running away" from stores and remained fairly optimistic. One large auto dealer group reported that sales of foreign-nameplate light vehicles were "doing fine," while sales of domestic-nameplates were weaker. This contact also noted a pickup in demand for smaller, more fuel-efficient vehicles. Demand for air travel continued to weaken in May, especially for business travel, and one contact in the industry indicated that the airline was increasingly shifting aircraft on routes to keep planes as full as possible. This contact also noted that the outlook for the industry over the next few months "is not a pretty picture."

Construction/real estate. Overall real estate and construction activity appeared to soften modestly in April and May, but remained strong by historic standards. New construction of office space was again strong in some areas, but with vacancy rates inching higher, projects "in the pipeline" have slowed. Residential real estate and construction activity appeared to be a little softer in the District than for the nation as a whole. New home sales remained below year-ago levels, according to many builders. One contact in a major metropolitan area noted that sales at the upper end of the new home market had slowed and a substantial inventory overhang had developed. Sales of existing homes also were off modestly from year-ago levels, but the general sense among realtors was that the market remained strong by historic standards. With little new development, apartment rents were said to be rising a little faster. One landlord, who had been pushing for 8 percent rent increases at turnover earlier in the year, more recently was pushing for 10 percent. This contact said that renters were "belly-aching" over the rent increases, but were paying them nonetheless.

Manufacturing. Manufacturing remained weak in April and May, but many industry contacts were optimistic that the worst was over for the Midwest's mainstay industries. Most of the region's manufacturers have been successful in working down excessive inventories by aggressively cutting production, but contacts cautioned that this was an ongoing process. Nationwide, light vehicle sales in May were off from year-ago results, but remained at high levels, according to contacts. Inventories were in good shape for automobiles, but slightly high for light trucks. Despite steel industry conditions that were described by one contact as "the worst in the post-war era," contacts were confident that the industry had "bottomed out" in the fourth quarter of last year. While still below year-ago levels, capacity utilization was up from earlier this year. Although inventories remained high, some of the excess had been worked down. Steel prices generally continued to languish near 20-year lows. New orders for heavy equipment were again very soft, but there was some modest firming in demand in a few segments, notably for energy-related and highway construction-related heavy equipment. Demand in the District's high-tech sector was reported to have been weak again in May.

Banking/finance. Overall lending activity moderated in April and May, with most of the weakness occurring on the business side. Demand for business loans remained at good levels, but lenders reported that many applications were being turned down because potential borrowers were more financially strained. Bankers continued to tighten standards and terms for business loans, though most contacts suggested that the majority of tightening was behind them. One lender noted that standards were being tightened more on loans to large businesses than to small businesses. Credit quality on business loans was said to have eroded slightly, but most of the deterioration was concentrated in loans to highly leveraged firms or those to companies in highly cyclical industries, like durable goods manufacturers. On the household side, credit card volumes were generally flat, while mortgage refinancing activity fell off in recent weeks as interest rates on fixed-rate mortgages continued to trend upward. A recent uptick in consumer credit defaults was said to be dissipating as the effects of higher winter heating bills waned, easing the strain on consumers' budgets. One contact noted that an increase in bankruptcy filings resulted from expected changes to bankruptcy laws.

Labor markets. Virtually all signs pointed to further easing in the District's labor markets in April and May. Indexes reflecting the volume of help-wanted advertising in local newspapers were down from last year in every major metropolitan market in the District, and initial claims for unemployment insurance in mid-May were running around 60 percent above last year. One contact noted that the number of continuing claims for unemployment insurance also appeared to be on the rise (mirroring a national trend) and suggested that idled workers were finding it more difficult to find new jobs. College graduates were finding the high-tech job market more challenging, with some students reporting that internships and job offers made a few months ago had recently been rescinded. Reports of worker shortages have largely subsided, though there were isolated reports of continuing shortages in certain areas and occupations. Wage pressures generally remained subdued, but there were further reports of intensifying pressure on non-wage employment costs, particularly for health benefits and other worker-related insurance.

Agriculture. District farmland values rose 1 percent, on average, in the first quarter of 2001, about the same as reported for each of the previous three quarters, according to a survey of agricultural bankers. Most farm debt continued to be serviced in a timely manner. However, an increased proportion of the bankers noted a higher incidence of requests for farm loan renewals and extensions, indicating some weakening in farm credit conditions. Most of the District's corn acreage has been planted and has emerged. Wet soil conditions slowed soybean planting in the western and northern portions of the District, leaving progress in Iowa and Wisconsin well behind a year ago.

EIGHTH DISTRICT - ST. LOUIS

Summary

The District economy, particularly the manufacturing sector, continues to show signs of sluggish growth. Growth at manufacturers continues to slow, and profit margins continue to narrow. Service providers are also feeling a pinch, but to a lesser degree. High fuel prices have forced some trucking companies to either cutback their fleets or shutdown. Housing markets are experiencing a seasonal boost, with sales and prices increasing around the District. Construction activity has also picked up. Banks have recently tightened credit standards on many of their loan products; at the same time, demand for some of these loans has weakened moderately. The spring planting is essentially complete. Crops are in good-to-excellent condition overall, although there has been some army worm damage reported.

Manufacturing and Other Business Activity

Contacts report that growth in the manufacturing sector has continued to slow, causing profit margins to narrow further. Many industries, such as furniture, recreational boat, aluminum, leather and auto parts manufacturers, continue to downsize and, in some cases, close plants. In northern Mississippi, for example, more than 1,800 jobs have been lost because several plants have closed or moved away. On the other hand, some manufacturing firms have made plans to expand or locate to the District. For example, firms in the high-tech, tobacco and chemicals industries plan to open new plants in Kentucky and Tennessee by next year.

The service sector has also been affected by the recent economic slowdown, but to a lesser extent than manufacturing. One area of concern, for example, is distribution and logistic services. A Memphis contact notes that there has been a slowing in the number of packages and amount of freight being shipped. Consequently, one of the District's (and nation's) largest package handling companies, FedEx, has announced a hiring freeze and a suspension of employee profit sharing. The trucking industry continues to experience profit losses because of the high price of fuel. These losses have forced many small trucking companies to file for Chapter 11 protection, while larger firms cope by parking portions of their fleets and laying off workers. Contacts have noted that recent earnings reports seem to foretell a possible ongoing decline in profits for the rest of 2001.

Real Estate and Construction

Residential real estate sales and median prices have continued to increase across the District over the past six weeks. Contacts in Tennessee, for example, report that the arrival of the spring buying season has brought with it a sellers' market. Homes in the mid-to-high price range ($150,000 and above) have been the fastest sellers. Commercial real estate activity has been more mixed. In parts of west Tennessee, for example, commercial real estate sales have been strong. In the St. Louis region, on the other hand, downsizing at several companies has increased the availability of sublease space, which has thwarted the momentum of commercial real estate sales. Vacancy rates in this area are up for both office and industrial space.

Residential construction is strong in most parts of the District. April monthly building permits in more than half of the District's metropolitan areas were up, in some cases by 15 percent or more. Year-to-date building permits through April in all but five District metro areas remained below their relatively strong levels of a year earlier. Contacts report that commercial construction is steady in the District. New or expanding jails, libraries, schools and universities are just a few of the projects that are underway in Indiana and Kentucky, for example.

Banking and Finance

Senior loan officers at District banks report that credit standards for commercial and industrial (C&I) loans have recently been tightened somewhat. The same is true for consumer loans and commercial real estate loans. Credit standards for mortgages, however, have remained relatively unchanged. Standards for lines of credit used to back commercial paper have also been tightened somewhat for lower prime-rated paper (A2/P2); standards on higher prime-rated paper (A1/P1) have remained unchanged.

At the same time credit standards have been tightened, demand for C&I and consumer loans has become moderately weaker, according to about half of the survey's respondents. Demand for commercial real estate loans and mortgages has remained essentially unchanged.

Agriculture and Natural Resources

The planting of corn, rice and cotton progressed rapidly during the first two weeks of May and is now virtually complete. Soybean planting this year is ahead of last year's pace in most parts of the District, despite on-again/off-again rain and cooler-than-normal temperatures. A contact reports that, although these conditions are slowing crop development and causing a "yellowing" to occur across some corn and soybean fields, they are not expected to cause much of a problem. Overall, the corn, soybean, rice and cotton crops appear to be in good-to-excellent condition in most parts of the District.

Contacts report army worm damage across the District—particularly southern Illinois, Indiana and Missouri—in hayfields, tall grass fields, pastures and some corn, soybean and winter wheat fields. The full extent of the damage to the wheat crop will not be known until the harvest is complete. The pace of the wheat harvest in Mississippi is modestly slower this year than last, with one contact suggesting that yields might be below average because of a wetter-than-normal winter.

NINTH DISTRICT--MINNEAPOLIS

The Ninth District economy is in the doldrums. Manufacturing, construction, mining and agriculture activities are down from a year ago. Consumer spending and tourism are flat. However, strong prices are helping the energy sector. Labor markets are easing and wage increases are moderating. Price increases are generally modest, although significant increases are reported in energy, health insurance, apartment rental rates and cattle hides.

Construction and Real Estate

Commercial construction is below last year's levels. Construction contracts awarded in Minnesota and the Dakotas decreased 4 percent for the three-month period ending in April compared with the same period last year. The downtown Minneapolis office market is slowing as tenants are planning to vacate leased space to occupy new buildings, according to a commercial real estate firm. In Billings, Mont., commercial real estate professionals noted that building during the beginning months of 2001 was on par with a year ago, but growth in construction is expected to finish the year lower. However, highway and heavy construction firms in northern Minnesota expect a busy summer.

Homebuilding is down from a year ago, while home sales are up. Housing units authorized dropped 15 percent in the district for the three-month period ending in April compared with a year earlier. City officials in Eau Claire, Wis., expect a lower number of single-family homes built in 2001 compared with last year. However, the value of home sales closed in April in the Minneapolis/St. Paul area increased 20 percent over a year ago, while the number of listings on the market was up 15 percent.

Consumer Spending and Tourism

Consumer spending is about level with a year ago. March retail sales in many South Dakota cities were down slightly from a year earlier. Sales in April and May at a mall in North Dakota, are down 5 percent compared with a year ago. In contrast, a major Minneapolis-based department store retailer noted that April same-store sales were up 1 percent over a year earlier. A mall in La Crosse, Wis., reports sales up 5 percent year to date compared with last year. Sales tax receipts were up 13 percent for the first five months of 2001 compared with a year ago in Grand Forks, N.D. Auto sales are on par with a year ago in North Dakota, according to a bank director; however, new car and truck registrations are off about 20 percent in South Dakota for March and April from last year.

Summer tourism activity in many parts of the district is expected to finish level with a year ago. Montana tourism is predicted to increase between 2 percent and 3 percent this summer compared with last year, according to officials. Advance reservations and inquiries are about the same as last year in the Black Hills area of South Dakota. Summer bookings at resorts in northwest Wisconsin are level with a year ago, according to a resort association representative.

Manufacturing

Overall manufacturing activity is, on balance, down from the last report. A May purchasing manager survey by Creighton University indicated slow manufacturing activity in North Dakota, very weak new orders in Minnesota but growth in manufacturing activity in South Dakota. A light truck assembly plant in Minnesota shut down for three weeks due to a shortage of tires. A cereal plant in Minnesota is closing, and production will move out of the district. In Minnesota, a communications component manufacturer suspended plans for an expansion, while a manufacturer of medical devices reports steady sales. A lumber mill in western Wisconsin shut down for two weeks due to slow demand and high inventories. Industrial electrical usage for the first quarter of 2001 in the Upper Peninsula was about level with year-earlier amounts. However, a Minnesota plastic molding producer reports sales are picking up after a lower-than-normal first quarter. A South Dakota building material producer reported an 8 percent increase in sales over last year.

Mining and Energy

The energy sector continued to expand in recent months, while the mining industry contracted. District oil and natural gas exploration and production remain above last quarter levels. Meanwhile, iron ore shipments in March were 21 percent below year-ago levels, and many mines are planning to curtail production by closing for a few weeks this summer. In Montana, a copper mine and an aluminum smelter remain closed due to high electricity prices. However, a Montana platinum/palladium mine remains at full production.

Agriculture

According to a Minnesota agricultural lender, "In this area the weather has caused planting problems. The prices for crops are not at profitable levels, and futures prices do not look like things will improve. Rents are stable with land values increasing. Stress will continue in the farm sector, and the equity of farmers continues to fall." This is a typical response to the Ninth District's second-quarter (preliminary May 2001) survey of agricultural credit conditions. Farmers' financial condition is sub-par; lenders report 30 percent of their agricultural customers are at their debt limit. In addition, 44 percent of survey respondents report below-average farm income over the past three months.

Employment, Wages and Prices

Companies are laying off workers; subsequently, labor markets show signs of loosening. A private university in Minnesota plans to eliminate 91 nonfaculty positions. A manufacturer of telecommunications components will cut 127 jobs in southwest Minnesota. A La Crosse shoe manufacturer will end operations in July, laying off 139 employees. The closing of a Bismarck, N.D., area telemarketing operation will result in 78 job losses. Initial claims for unemployment insurance in district states are up 55 percent for the four-week period ending May 19 compared with a year earlier.

An advisory council member from northwest Wisconsin reported that the area's labor shortage has eased from eight months ago. A representative from a temporary-staffing and placement firm that specializes in technical and computer positions in the Minneapolis area is receiving many more resumes from people who have been laid off.

In contrast, some industries continue to face tight labor markets, and a number of companies are hiring workers. In Minneapolis/St. Paul, 34 percent of companies surveyed by a major staffing company plan to hire more workers during the third quarter of 2001, while 9 percent expect to reduce staffing levels. This compares with 36 percent and 12 percent, respectively, a year ago.

Wage increases are modest, with manufacturing wages up 2.6 percent for the three-month period ending in April compared with a year earlier. A bank director reported that executive pay at a Minneapolis/St. Paul high-tech firm is down 10 percent from a year ago, while entry level jobs at most high-tech companies are seeing only 3 percent to 6 percent pay increases.

Overall price increases are modest, except for notable hikes in energy, health insurance, apartment rental rates and cattle hides. Higher gasoline prices are reported throughout the district, increasing costs for shipping and transportation. Health insurance costs are up 20 percent, according to bank directors. Average apartment rental rates in St. Paul are up about 15 percent in April from a year ago. Meanwhile, cattle hide costs for shoemaking are up 40 percent compared with last year.

TENTH DISTRICT - KANSAS CITY

Overview. The Tenth District economy remained somewhat weak in May. Retail sales were flat, manufacturing activity continued to slow, and commercial construction showed little change from previous surveys. On the positive side, residential construction continued to edge higher and energy activity continued to expand. In the farm economy, the district's winter wheat crop was in poor condition. District labor markets appeared to ease further, especially for retail workers, and reports of wage pressures were rare. Retail prices and prices for construction materials held steady, while prices for some manufacturing materials edged lower.

Retail Sales. Retail sales were basically flat in May, and up only slightly from a year ago. Women's clothing sold well, as did outdoor furniture. Sales of men's clothing were generally weak. Retailers trimmed inventories but remained generally satisfied with current stock levels. Expectations of summer retail sales have weakened somewhat since the previous survey. Motor vehicle sales resumed declining in May after improving in the previous survey, and were down from a year ago throughout the district. These weaker conditions have led to the closure of a few dealerships. Many dealers noted that sales of SUVs and pickup trucks were down due to higher gasoline prices. Despite the fall in sales, inventories of unsold cars also declined, and most dealers remained satisfied with their inventories. Expectations of vehicle sales in the summer were cautiously optimistic.

Manufacturing. District factory activity weakened further in May, as fewer firms operated at a high level of capacity utilization than in previous surveys. Lead times were unchanged and no material availability problems were reported. Inventories rose slightly due to weaker sales, and many plant managers reported that their current stock levels were higher than desired. Most managers hope to trim inventories during the summer.

Real Estate and Construction. Residential construction activity continued to expand modestly in May, while commercial building remained flat. Housing starts rose slightly from April but remained largely unchanged from a year ago in most of the district. Builders expect a general leveling out of residential construction in coming months. Sales of new and existing homes were flat, and inventories of unsold homes reached record levels in some areas, particularly for luxury homes. Mortgage demand weakened, primarily due to a slowdown in refinancing activity, although activity remained higher than a year ago. Most lenders expect the mortgage market to weaken further. Commercial construction activity has remained roughly constant since the previous survey. Absorption rates have remained steady and vacancy rates have increased only slightly. However, realtors indicate that vacancy rates would be higher if the subleased space that has come onto the market in recent months were included.

Banking. Bankers report that loans and deposits both increased since the last survey, leaving loan-deposit ratios unchanged. Demand rose for all loan categories except commercial real estate loans and agricultural loans. On the deposit side, demand deposits and NOW accounts both increased, outweighing a small decrease in large CDs. All respondent banks reduced their prime lending rates, and most 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.

Energy. Energy activity in the district continued to expand rapidly. The count of active drilling rigs rose further in May to reach a new 11-year high, as energy prices remained high by historical standards. Energy firms continued to lure rig workers back to the industry as rapidly as possible, but shortages of workers and rigs continued to restrain drilling activity.

Agriculture. Much of the district's winter wheat crop was in poor condition due to the dry autumn and harsh winter, and recent rainfall has slowed planting of the district's spring crops. Strong livestock prices have encouraged some ranchers to expand their cattle herds, but the expansion has been limited by the high price for replacement breeding stock. Despite strong livestock prices, district bankers expect low crop prices and high fuel and fertilizer costs to hold down farm incomes this year. As a result, bankers are keeping a close watch on their farm loans. With farm incomes still weak, small business activity in rural areas has slowed from a year ago.

Wages and Prices. District labor markets appeared to ease further in May, although the market for skilled workers remained tight. Many small construction contractors continued to have problems finding tradesmen, and some kinds of manufacturing jobs remained difficult to fill. On the other hand, the market for retail workers has loosened considerably in recent months, with one source reporting a flood of applicants. Wage pressures were virtually nonexistent outside of the energy sector. In some contract negotiations, workers are now reportedly favoring the increased security of longer contracts over higher wages. Retail prices held steady in May, although there were continued concerns about the effect of rising transport costs. Prices for some manufacturing materials, such as steel and plastics, edged lower. However, high transportation and petroleum costs remained a concern. Overall, most purchasing managers expect material prices to remain steady throughout the summer. Building material prices remained largely unchanged.

ELEVENTH DISTRICT—DALLAS

Eleventh District economic activity continued to decelerate in April and May. Manufacturing activity showed signs of stabilizing after deteriorating for most of 2001. Most retailers said the level of sales was flat or up slightly over the past six weeks. However, growth in the demand for business services continued to decelerate while construction and real estate markets continued to cool. Lending activity continued to slow while non-performing loans and delinquencies increased. Energy activity continues to accelerate. Agricultural conditions have been generally favorable

In general, contacts in most industries are expecting activity to remain sluggish throughout the year. A few contacts believe activity may pick up some in the second half, others are focused on the fourth quarter and some are looking for a pick up in 2002. Several contacts mentioned a high degree of uncertainty, with the pace of economic activity being driven by consumer confidence (or lack thereof).

Prices. Stiff competition, excess capacity and high inventories are putting downward pressure on selling prices in several industries. Inventories of telecommunications products remain very high, and selling prices continue to fall. Auto dealers also report declining selling prices and say nearly all manufacturers are offering big incentives. Airlines have been offering major discounts on summer airfares. Airlines recently raised rates to cover rising labor and fuel prices, but the increase was quickly rescinded by all major airlines. Rising capacity has put downward pressure on petrochemical prices.

High fuel costs remain a concern for many firms. Crude oil prices held steady in May, despite a buildup in inventories, which are about 8 percent higher than a year ago. U.S. average retail gasoline prices have risen to over $1.70 in recent weeks. Gasoline inventories remain near the very low levels of last year, and inventories of reformulated gasoline are 9 percent lower than a year ago. With 36 types of fuel to stock in different regions, spot shortages in some regions of the country are expected. High natural gas prices are pressuring feedstock costs for products such as styrene, polyester, and benzene. Fuel surcharges have increased in the railroad industry. Natural gas prices have drifted downward steadily, as mild spring weather allowed for record levels of injections into storage fields, but inventories are 11 percent under the six-year average for this time of year.

Prices are rising for energy-related products and services, such as onshore and offshore rigs, supply boats, fabricated metals used in the energy industry, and all types of energy equipment. Selling prices have also been rising for lumber, and inventories are gradually dropping down to desired levels. Paper prices, which had been falling, now appear to be stabilizing.

Labor Markets. Labor markets have eased in many areas, although there continue to be pockets of tightness. For example, IT workers, who were in short supply several months ago, are now available, but engineers, welders and office workers are still difficult to find in some areas. Several contacts noted that employee turnover has slowed, helping reduce wage pressures. Still, rising labor costs remains a concern for most companies, particularly because of soaring costs for health care benefits.

Manufacturing. Overall manufacturing activity was uneven with some areas of recovery while other areas continued to deteriorate. In general, however, industries that have been contracting do not expect to decline further. Improved weather led to a pickup in the output of construction-related products, such as lumber, brick, stone, cement and glass. Contacts are unsure if the pickup is an indicator that business is picking up or just a resumption of weather-delayed projects. Paper producers also reported an increase in sales. Some paper producers have had difficulty keeping up with the increase in demand because they slowed production earlier in the year.

Several manufacturers reported that sales remained unchanged or continued to deteriorate. Glass producers supplying the automotive industry report no change in demand. Demand for food products also remained unchanged over the past few weeks, but demand for apparel products was below that of a year ago. Demand for primary metals continued to soften over the past few weeks, and factories are not running at capacity. Contacts attribute slow sales to weakness in automotive, trucking, agriculture and commercial construction. Fabricated metals producers also report slower activity, except for products related to the energy industry.

Demand for telecommunications products appears to be stabilizing at extremely low levels, with the rate of decline slowing. Sales are about 25 percent below a year ago, and telecommunications firms continue to "ramp down" production. Sales of other high-tech products weakened over the past few weeks, across both consumer and business products. Most of the weakness continues to come from the U.S. market, but several respondents reported weakening sales in Europe. Excess capacity has increased and was reported to be very significant in semiconductors and telecommunications. Some respondents said that inventories were well managed, but others reported a buildup of parts and finished goods. There appears to be a general consensus among contacts that the industry is at or very close to the bottom with a turnaround likely to begin in the fourth quarter.

Petrochemical capacity continued to come back on line as natural gas prices drifted downward. Demand for petrochemicals is weak, however. U.S. feedstock prices make production noncompetitive in world markets because domestic producers use natural gas as a feedstock while most international producers use oil. High gasoline prices are generating excellent profits for refiners. Refineries are operating at very high levels of capacity utilization to take advantage of the very strong margins.

Services. Demand for business services remains soft. Contacts expect activity to remain sluggish throughout the year, but do not expect further deterioration. Temporary service firms say many of their customers have put hiring in a "holding pattern." Activity is slowest at manufacturing and high tech firms, while energy and banking firms are areas of strength. Demand for high-skilled labor is stronger than for lower-skilled labor, according to temp firms, who report an increase in the number of workers seeking employment, particularly professionals. Legal firms reported slower growth than a year ago, but contacts say activity is still quite good. Legal firms also report a slowing of fee collections from their customers, which they have not seen for a few years.

Transportation firms report continued sluggish demand. Airlines say demand from both leisure and business travelers has softened. Railroad activity has slowed due to flooding in the upper Midwest and fewer auto shipments, but shipments of coal and petroleum are up, and shipping of international containers is up slightly. Higher fuel prices have led truckers to lose short haul business to railroads because railroads use fuel four-times more efficiently.

Retail Sales. Most retailers said the level of sales growth was flat or up slightly over the past six weeks. Inventories are generally in good shape. The industry is very competitive and contacts say that selling prices are at or below the levels of a year ago. Some costs were up, particularly for energy, transportation and medical. As a result, most contacts said that margins had narrowed. Auto sales are picking up slowly, but year-to-date figures are still below 2000. Auto inventories remain high, but dealers were less worried about the excess inventory because of the recent pickup in demand. Houston auto dealers reported very strong auto sales in April.

Financial Services. Lending activity continued to slow while non-performing loans and delinquencies increased. Most of the slowing was reported in large, urban banks, but the slowing is spreading to traditional banking type services, which is affecting smaller and independent banks. Commercial and consumer lending categories are the slowest. Interest rate decreases have spurred mortgage refinancings but have not dramatically stimulated other lending. Credit standards continued to tighten for some borrowers, and loan-to-deposit ratios have fallen significantly since late last year. Many contacts stopped lending late last year because of funding shortages. Now, many are flush with cash but are leery about making new loans. Most contacts are optimistic that the second half of the year will be better than the first half.

Construction and Real Estate. Construction and real estate markets continued to cool, except in Houston, where the energy industry is boosting activity. Residential markets have softened. Homebuyer traffic has slowed, and there has been an increase in cancelled sales, which contacts attribute to job losses and rumors of job losses. Despite the slowing, contacts reported strong demand at mid- to lower price points. The supply of commercial space continued to outstrip demand, as many tenants reduced their leased space. There has been an increase in subleasing, and rents have stopped rising.

Energy. The domestic rig count continues to climb, reaching 1262 rigs in May. Natural gas remains the focus of drilling, with 82 percent of drilling directed toward natural gas. Contacts report that as many as 10 rigs may be leaving the Gulf of Mexico to work other regions of the world. This is good news, they say, because the rigs came to the US for lack of work overseas, and it indicates that major new international projects may be starting. The foreign rig count remains 12 percent below its last peak in 1997.

Agriculture. Conditions have been generally favorable for farming and livestock activities. Land preparation and planting progressed across the state with only minor weather delays. Insects caused increasing damage to crops and pastures, and some producers were electing not to fight the invasion as the cost of chemicals and fuel make it economically unfeasible.

TWELFTH DISTRICT–SAN FRANCISCO

Reports from Twelfth District contacts point to a deceleration in economic growth in May, with slowing evident in most sectors. Respondents reported less cost pressure on non-energy inputs, but noted that rising energy prices continued to damp profitability. Higher unemployment rates eased wage and salary growth in many areas of the District, but rising benefit costs remained a concern. Retailers and service providers in the District noted slower sales growth, particularly for big-ticket items such as cars and electronics and luxury services such as high-speed Internet access and wireless web phones. Higher energy prices and softening demand for high-tech goods continued to depress the District's manufacturing sector, with many firms reducing output and cutting jobs. Agricultural producers remained strapped by low commodity prices and higher input costs. Respondents noted increased weakness in residential and commercial real estate markets throughout the District in recent weeks, owing largely to the downturn in the technology sector and uncertainty about the economy. Credit conditions weakened slightly in May, as loan demand fell, delinquencies rose, and lenders tightened credit standards.

Wages and Prices

Twelfth District contacts reported falling prices on many non-energy inputs and consumer products. Intense competition and inventory overhang continued to depress prices for producer inputs and consumer durables. Electronics and apparel retailers reported considerable price discounting in an effort to clear out accumulated inventories. Appliance and automobile sellers also reported heavy discounting, particularly for top-of-the-line merchandise. In contrast, prices on most consumer non-durable goods remained stable or rose slightly as energy surcharges were applied.

Energy costs for businesses and consumers increased further in May, and additional rate hikes are expected in June. Respondents noted that higher energy costs increasingly are being passed on to consumers, typically in the form of energy surcharges. However, the price pass-throughs remained partial and higher energy costs continued to cut into profits. A dominant theme among respondents was their use of conservation measures to reduce energy costs. The most common conservation measures included lowering lighting and air conditioning during work hours and shutting off lights, computers, and monitors during off hours. Respondents noted that some businesses—for example, restaurants, laundries, lumber and wood product makers, and food processors—have cut back hours of operation to reduce energy costs.

Looser labor markets eased wage and salary pressures in many District states, although wage demands by entry-level workers remained high. In contrast, wages for mid-level employees and all but the best high-skilled workers stabilized, with many contacts reporting average wage increases of between zero and one percent this year. Rising benefit costs remained a concern for many District employers.

Retail Trade and Services

District retailers and service providers continued to report weaker-than-expected sales growth, particularly for big-ticket-items and luxury services. Sales of automobiles, appliances, furniture, and consumer electronics such as entertainment systems and computers, fell short of projections in recent weeks and ran behind sales for the comparable period last year. Food and pharmaceutical sales continued to increase, but at a slower pace than earlier in the year. District service providers noted weaker demand for cable and Internet connections and wireless phone service, particularly for high-end packages including multiple hookups and wireless web access. Rising gasoline prices and consumer uncertainty appear to be restraining travel to the District's high-end tourist destinations. Tourist counts and revenues were down in Hawaii and Las Vegas and at destinations such as golf schools and luxury resorts in the Intermountain states and along the West coast.

Manufacturing

Conditions in the District's manufacturing sector weakened further in May. Orders for semiconductors continued to decline, boosting inventories, pushing prices and capacity utilization well below projections, and leading some producers to furlough employees and reduce work hours. Producers noted that a growing portion of inventory will be outdated before it can be sold. District producers of non-high-tech products such as lumber and wood products, aluminum, apparel, and processed foods continued to be hit hard by rising energy costs, falling export demand, and greater import competition. Producers in these sectors reportedly have exhausted their ability to improve productivity and pass costs on to buyers, making job cuts the only way to reduce costs.

Agriculture and Resource-Related Industries

District agricultural conditions remained weak. Low commodity prices and rising fuel costs continued to squeeze profit margins. Inventories of many products are building up and storage space is becoming constrained. Deteriorating weather conditions in the Intermountain states added to these concerns; drought-like conditions eliminated grazing opportunities and forced ranchers to purchase feed, boosting expenses. Oil and gas producers face better times, with drilling and investment growing at a rapid pace.

Real Estate and Construction

Residential and commercial real estate markets in the District remained sound in May, although increased signs of weakening were noted in most regions. Contacts reported softening in residential real estate markets, with the most pronounced slowing in the hottest markets—the San Francisco Bay Area, Phoenix, and Seattle—and in the market for high-end homes. Respondents noted that home buyers and sellers seem to be in a holding pattern, waiting for the market to stabilize. The slowdown was not limited to home sales; contacts in many areas of the District reported rising apartment vacancy rates and falling lease rates. Contacts in the San Francisco Bay Area noted that landlords have begun to offer special lease deals and reduced lease rates to attract residents.

Commercial real estate markets also saw increased vacancy rates and falling lease rates. The collapse of the dot-com sector as well as ongoing downsizing among high-tech manufacturers and software companies has put a large amount of sublease space on the market, particularly in the San Francisco Bay Area and Seattle. General slowing in the economy has increased vacancies in Portland and Salt Lake City. Construction is responding to the change in market conditions. Respondents noted that a number of large long-term projects have been put on hold until the market stabilizes.

Financial Institutions

District financial institutions reported additional weakening in credit conditions in May. A number of contacts reported that profitability among firms with outstanding loans has become a concern among lenders. Increased loan delinquencies were reported in many areas of the District in May and lenders noted a tightening of credit standards. Small business loan demand fell in recent weeks, as borrowers became more cautious about expanding.