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Summary of Commentary on

Current Economic Conditions

by Federal Reserve District

October 2002

SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICTS

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TABLE OF CONTENTS

Summary*

Most districts reported that economic activity remained sluggish in September and early October. Retail sales were weak across the nation, including some declines in motor vehicle sales from very high levels. Most districts noted that manufacturing activity had declined or grown more slowly. Home building and residential markets were generally upbeat. Commercial real estate markets softened. The agricultural sector was mixed; many areas were hurt by drought, but other regions reported ideal growing conditions and bountiful harvests. The energy sector had slowed, and mining activity was uneven. Labor markets were lackluster in all districts. Overall wage and price increases were moderate, but significant price increases were noted in health care, insurance and shipping. Most districts reported strong consumer loan demand and weak commercial lending activity. Credit quality deterioration was reported in some districts.

Consumer Spending

All districts noted weak retail sales in September and early October, while tourism activity was mixed. In the Cleveland, Minneapolis and Philadelphia districts, retail sales declined during September. Chicago, Dallas, Kansas City and San Francisco reported that sales growth had slowed. In the New York district, retail sales were below plan. Clothing retailers noted slow sales in St. Louis. Retail establishments gave varied reports in the Richmond district, while sales were near low year-ago levels in the Atlanta

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* Prepared at the Federal Reserve Bank of Minneapolis and based on information collected before October 15, 2002. 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.

district. Boston reported a modest pickup in sales in September after experiencing flat to declining sales during the previous two months.

Motor vehicle sales generally slowed from very high levels. September and early October auto sales decreased in the Atlanta, Dallas, Chicago, Minneapolis and Philadelphia districts. Cleveland, St. Louis and San Francisco reported that sales grew more slowly. However, vehicle sales were mixed in the Richmond district and were slightly higher than a year ago in the Kansas City district, although auto dealers there expressed uncertainty about future sales.

Tourism activity was mixed. Fall tourism was solid in several parts of the Minneapolis and Kansas City districts but was uneven in the Chicago and Richmond districts. Meanwhile, most reports from the Atlanta district's hospitality and tourism sector were more downbeat than previously indicated, and travel demand was sluggish in most areas of the San Francisco district.

Manufacturing

Manufacturing activity decreased or grew more slowly in September and early October for most of the districts. "Tough," "stagnant," "sluggish" describe manufacturing conditions in many districts. Richmond reported that shipments, new orders, capacity utilization and employment all declined. Dallas indicated weakened activity in all manufacturing industries. Chicago noted weak demand for heavy equipment. However, the St. Louis and Minneapolis districts reported slight increases in manufacturing activity. Many districts reported reluctance of manufacturers to undertake capital spending.

Real Estate and Construction

Home building and residential real estate activity was positive, although softening was noted in some regions and in the higher end of the market. Chicago and Minneapolis reported overall strong home building activity. Residential real estate markets in the Boston, Kansas City and San Francisco districts were strong overall, but contacts noted slowdowns in some areas. While growth in home sales slowed somewhat in the Richmond district, residential real estate remained upbeat. Little changed for home builders in the Cleveland district. Residential real estate markets in New York showed signs of softening, particularly at the upper end of the market. The demand for higher-priced homes was weak in the Atlanta district, and activity in the single-family market tapered off in the Dallas district.

Commercial real estate and construction activity softened in several districts. Atlanta, Chicago, Cleveland, Kansas City, Minneapolis and San Francisco reported weak conditions in commercial real estate markets. Commercial realtors reported generally flat leasing activity in the Richmond district. While office vacancy rates rose in Dallas, public projects remained a source of strength. In New York, commercial real estate markets were mixed. The demand for commercial real estate was very high in St. Louis; however, construction was slow.

Agriculture

The agriculture sector showed mixed results during September and early October. Dallas and San Francisco reported favorable conditions. San Francisco noted that yields and sales of fruits, vegetables and nuts were high. Meanwhile, Atlanta, St. Louis and Minneapolis reported varied conditions. Atlanta reported that Florida citrus and sugar production benefited from adequate rainfall and warm temperatures, but excess moisture hurt soybean production in Louisiana and Mississippi. Cleveland, Richmond, Chicago and Kansas City reported deteriorated conditions primarily due to drought.

Natural Resource Industries

Energy exploration activity declined, while mining activity varied. Minneapolis, Kansas City and Dallas reported weak drilling activity for oil and natural gas, but contacts in Kansas City and Dallas anticipate some pickup in the near term. Meanwhile, Minneapolis indicated mixed results in mining.

Labor Markets

Labor markets were lackluster, with only a few reports of increased hiring. Employment demand softened somewhat in Chicago and Minneapolis. In New York the overall market was sluggish, while Atlanta and Boston noted mostly flat employment levels. Labor markets were slack in Kansas City; however, Richmond and Philadelphia reported increases in demand for temporary employment. St. Louis reported fewer layoffs by manufacturers, but some noted that they planned to hold off on new hiring.

Wages and Prices

Increases in wages were generally subdued. Wage pressures remained virtually nonexistent in the Kansas City district. Chicago, Minneapolis and San Francisco reported little upward pressure. In Dallas, contacts in the temporary services industry noted downward pressure on wages. Wages increased 3 percent to 4 percent in the Boston district.

Overall prices were reported as stable, with significant increases noted in health care, insurance and shipping. Vendor and selling prices remained steady in Boston. San Francisco and Minneapolis reported little upward pressure on prices. Boston and Atlanta indicated decreases in lumber prices. Retailers in the Chicago and New York districts noted little pressure on prices. Some districts, however, reported price increases. Health care costs continued to escalate in the Atlanta district. Significant insurance cost increases were noted by Dallas and Minneapolis. San Francisco and Minneapolis reported increased shipping prices, due in part to the work stoppage at West Coast ports.

Financial Services

Most districts noted that consumer lending demand, especially residential, was strong, while commercial lending demand was weak. Some districts indicated slight credit quality deterioration. Most districts reported very strong demand for home refinancing. Meanwhile, Boston reported that life insurance companies continued to see strong demand. However, most districts indicated low commercial loan demand. For example, Richmond reported that businesses reduced borrowing due to an uncertain economic environment. Philadelphia, Cleveland, Chicago and San Francisco reported a slight deterioration in credit quality in some sectors. Philadelphia noted recent deterioration in credit quality of consumer loans, and San Francisco indicated increasing delinquencies and loan defaults in some markets.

FIRST DISTRICT – BOSTON

The economy remains soft in New England. Most manufacturers report sluggish revenues. Some retailers, by contrast, indicate sales picked up modestly in September. Residential real estate markets are holding up well, although slowing in spots. Insurance respondents report strong demand.

Retail

First District retailers generally report flat to declining sales in July and August compared to a year earlier, with a modest pick-up in September. An office supply store says that a late start for back-to-school shopping caused some alarm, but sales began to improve in mid-August and continue to grow. Furniture and electronics retailers report a slight increase in sales in September; however, computer sales are down. Lumber and hardware store sales are generally flat or down, although one contact specializing in smaller home improvement projects indicates sales are on target and ahead of last year. Some retailers have intentionally raised inventories slightly, displaying caution over the West Coast strike; having greater stocks available to customers has reportedly helped boost sales.

Employment remains mostly flat; however, one contact is eliminating positions through attrition and another undertook layoffs in July. Wages are increasing at about a 3 to 4 percent annual rate, but some contacts are reporting more selective increases than in the past. Vendor prices and selling prices remain stable, although lumber prices are said to be low because of oversupply. Most retail contacts are keeping capital spending to a minimum, postponing major projects until next year or until sales pick up. Profit margins are generally stable, although some respondents cite increases from last year.

Most New England retail contacts remain uncertain about the future. They say soft consumer confidence is the primary cause of weakened sales, so a confidence turnaround will be the determining factor for improvement. Many respondents foresee no significant pick-up until spring of 2003.

Manufacturing and Related Services

Most First District manufacturing contacts report that business conditions continued to be tough through the third quarter, with revenues not much changed from a year earlier. Manufacturers say that their retail and restaurant customers are struggling, causing them to skimp on stocking products and modernizing equipment. One maker of upscale consumer instruments reports that retailer demand finally picked up in September, but the company does not know yet whether this represents positive expectations about the holiday season or mere restocking.

Manufacturers say that commercial demand for aircraft parts, computer hardware, and electronics remains depressed, with some contacts saying that September orders came in weaker than anticipated. Companies in the semiconductor industry report mixed patterns, with one firm enjoying record revenues on the strength of overseas demand, and another firm saying that its own third quarter was "decent" but that the industry as a whole is headed for a double dip. By contrast with downbeat sectors, manufacturers say that demand for defense and medical equipment is continuing to rise, and contacts in a variety of industries indicate that, except for Japan, Asia is an improving or strong market.

Selling prices are mostly flat to down. Many firms comment that they have no pricing power. Materials costs are largely flat, except for increases for steel and oil-related products.

Most manufacturing contacts have recently announced or will soon announce employment cutbacks. They are undertaking layoffs in order to restore or improve profitability or as a response to weaker demand in particular segments (especially aircraft and financial services). The few firms that need additional labor are relying largely on temporary help and outsourcing.

Most respondents plan to reduce their capital spending in 2003. Many say they face cash flow constraints (exacerbated, in some cases, by the need to make added pension fund contributions). Some makers of high tech and aircraft products indicate that they have so much excess capacity they will not need to increase capital spending until 2005 at the earliest.

Residential Real Estate

New England residential real estate markets are still strong, although contacts report slowdowns in some parts of the region. Low interest rates continue to stimulate demand, which outpaces supply in many areas. However, uncertainty about the economy and lack of consumer confidence have damped sales activity in some states; properties stay on the market longer than they did in the first half of the year, and inventory is building up in some price ranges.

In Massachusetts, "empty nesters" compete with first-time buyers for condominiums and low-end single-family homes, generating substantial price increases – condo prices were reportedly 20 to 30 percent higher this summer than a year ago. Single-family home prices increased as well, albeit at a more moderate pace. However, the number of home sales in the state during each of the summer months was lower than a year earlier, and contacts predict that price appreciation will slow by the end of the year.

In Vermont and Rhode Island, the markets are slowing and low-end inventory is said to be building up. However, Connecticut and New Hampshire report active markets and continuing inventory shortages. Contacts across the region anticipate that residential markets will remain stable as long as interest rates stay low.

Insurance

Life insurance companies continue to see strong demand, with year-to-date sales growth of 30 to 40 percent. Respondents say rising demand is explained by a variety of factors, including introduction of new products, increased awareness of risk after September 11, and marketing efforts. Employment and capital spending remain roughly flat, with only selective investments aimed at improved productivity. The near-term outlook is positive, with companies projecting sales growth of 25 to 30 percent.

Property and casualty insurers also report strong demand together with substantial increases in rates, ranging from 10 to 25 percent for this year. Total revenues are up 8 to 20 percent year-to-date. Respondents in this sector note that property and casualty rates had been under-priced and are now returning to normal, as last year's terrorist attacks and the low stock market uncovered problems with underwriters, previously masked by stock market gains. Capital spending is generally flat, although one firm reports a 12 percent increase to replace software. Employment is also flat, with one respondent planning a 5 percent increase in 2003. The outlook remains favorable, with prices expected to continue to rise and an estimated future revenue growth in the range of 10 to 20 percent.

SECOND DISTRICT--NEW YORK

The Second District's economy has shown further signs of slowing since the last report, while prices of goods and services were reported to be flat to down slightly. The job market remains weak, reflecting cutbacks in the financial sector, and scant hiring activity in most industries, except for legal services. Retail sales were reported to be well below plan in September and early October, and inventories were generally said to be higher than desired, but still lower than a year ago. Retailers report more discounting than in the last report.

Surveys of manufacturers indicate that business conditions remained favorable in September but deteriorated in early October; still, most respondents remain optimistic about the near-term outlook. Housing markets have softened in recent weeks, particularly at the high end, though selling prices overall continue to run ahead of a year ago. Lower Manhattan's office market appears to have stabilized, but commercial real estate markets in most of the metropolitan area have weakened moderately. Finally, bankers report stable loan demand, ongoing tightening in lending standards and stable delinquency rates.

Consumer Spending

Retailers report that sales were well below plan in September and early October. Major chains report that same-store sales ranged from a 7 percent decline to a 5 percent gain, though the year-earlier figures were depressed by the terrorist attack—particularly for stores in New York City. As has been the case for a number of months, apparel sales were especially sluggish, and warm weather was seen as only a minor factor. In contrast, small-ticket goods for the home—towels, linens, pots and pans—sold well, while sales of major appliances and electronics were mixed.

Inventories were mostly reported to be lower than a year ago but higher than desired. In addition to the unexpectedly weak sales, some contacts report that they accumulated extra inventories in anticipation of the West Coast dock strike. Retailers indicate that they were not significantly affected by the dock strike, but contacts express concern that a resumption of the strike or a prolonged work slowdown would cause problems in getting merchandise. Most chains say that selling prices and merchandise costs are steady to down slightly and also report increased discounting.

Regional consumer confidence surveys indicate increased optimism in September. According to the Conference Board, confidence in the Middle Atlantic region rebounded strongly in September, after falling to a cyclical low in August. Similarly, the latest monthly survey of New York State residents, conducted by Siena College, indicates that confidence rose moderately in September for the second month in a row.

Construction and Real Estate

Residential construction and real estate markets have shown signs of softening since the last report—particularly at the upper end of the market. In the New York-New Jersey region, permits to build both single- and multi-family homes fell in August. Multi-family permits were still up 7 percent from a year earlier, despite a decline in New York City; however, single-family permits were down 11 percent. Homebuilders in northern New Jersey report that, while demand remains fairly robust, homebuyers are opting for less expensive homes, though many continue to spend a good deal on add-ons and amenities.

The resale market has also shown signs of softening, most notably at the high end. New York City realtors report that the market for co-ops and condos has weakened substantially since the last report, particularly for the highest-priced apartments. One contact notes that, compared to the market peak this past Spring, the inventory of unsold homes has risen by roughly 60 percent and that prices are off about 10 percent. Similarly, a northern New Jersey realtor reports a sizable increase in the number of homes on the market, and has found that nearly two-thirds of homes selling for over $1 million have been on the market for over two months—an unusually large proportion.

Commercial real estate markets have been mixed. In Lower Manhattan, the office market has stabilized in the third quarter: availability rates held steady and asking rents, though down 11 percent from a year earlier, have rebounded slightly since midyear. However, markets across most of the metropolitan area have weakened moderately. Vacancy rates rose in Midtown Manhattan, Westchester and Fairfield

Counties, Long Island and northern New Jersey. Asking rents in most of these areas are little changed from a year ago, with the exception of Fairfield County, where they are down 12 percent.

Other Business Activity

A leading employment agency indicates that the job market remains sluggish overall, though there continues to be brisk hiring from the legal industry. Financial services firms are reported to be hiring only sporadically, and most are reducing staff levels overall. A contact from New York City's securities industry expects that industry-wide layoffs will intensify in the fourth quarter, and that bonuses will be down at least 25 percent from last year, reflecting continued weakness in profits. While trading volume has reportedly picked up in recent weeks, fees and commissions have been compressed, and higher-margin activities—such as mergers, acquisitions, and initial public offerings—are doing poorly.

Recent surveys of purchasing managers and manufacturers indicate continued favorable business conditions in September but some weakening in early October, with mixed signals on input prices. Buffalo-area purchasers report increases in both production activity and new orders in September, as well as a moderate increase in commodity price pressures. Purchasing managers in the New York City area report a leveling off in the local manufacturing sector in September, after months of widespread gains, and no change in input prices; those outside the manufacturing sector report continued weakness and declines in input prices.

Separately, our latest monthly survey of New York State manufacturers indicates some deterioration in business activity in early October—both new orders and shipments are reported to have turned down moderately, while unfilled orders continued to recede. Still, respondents continue to express widespread optimism about the near-term business outlook. Input price pressures increased in October, but selling prices were steady to lower.

Financial Developments

Bankers at small to medium-sized Second District banks report increased demand for mortgage loans, but stable demand for consumer loans and commercial and industrial loans. Over half of the bankers surveyed indicate higher demand for residential mortgages, while only 9 percent indicate lower demand. For nonresidential mortgages, 40 percent report higher demand, while 20 percent report lower demand. Widespread increases were also reported in refinancing activity.

On the supply side, credit standards continued to tighten—most notably on nonresidential mortgages and commercial and industrial lending. Loan rates continued to decrease for all types of loans, particularly for residential mortgages and consumer loans. A large majority of bankers also report declines in deposit rates. Lenders report stable delinquency rates for most types of lending, with the exception of nonresidential mortgages, where delinquencies fell.

THIRD DISTRICT – PHILADELPHIA

Business conditions in the Third District were mixed in October. Activity declined in some sectors but improved slightly in others. Manufacturers reported some slowing in orders and shipments. Retail sales of general merchandise have ebbed. Auto sales have slowed also. Bank loan volumes increased somewhat, mainly because of growth in residential mortgages and consumer loans. In the service sector, temporary and permanent employment agencies reported a small increase in demand for sales and administrative workers. Information technology service firms have seen slight increases in demand from private sector firms and government agencies, but telecommunications firms continued to report flat or declining activity.

Forecasts among Third District businesses vary. Manufacturers generally expect improvement during the next six months despite current sluggishness. Retailers see no signs that sales growth will improve for the holiday season. Auto dealers anticipate further slowing in sales this year. Bankers expect continued gains in residential mortgage and consumer lending, but they say prospects for business lending are uncertain. Employment agencies expect a relatively steady fourth quarter and a possible pickup in hiring soon after the start of next year.

MANUFACTURING

Manufacturing activity in the Third District eased somewhat in October compared with September. New orders and shipments were mixed among the firms contacted, with the largest number reporting no change from September to October and slightly more firms seeing declines than increases. Conditions varied among the region's major manufacturing sectors. Firms that manufacture products used in residential construction had strong demand for their products, as did some firms that produce transportation equipment. Firms producing materials for commercial construction reported weakening demand, as did firms in the metals and electrical machinery sectors.

There has been little change in manufacturers' forecasts recently. Half of the firms surveyed in October expect increases in orders and shipments during the next six months, while fewer than one in 10 anticipate decreases. Expectations for improved business are fairly widespread among the major manufacturing industries in the region. However, many firms that produce metal products reported they are facing growing foreign competition, and firms in all manufacturing industries indicated that the threat of armed conflict in the Middle East is prompting them and their customers to be more cautious in their business plans. Nevertheless, around one in five of the manufacturers contacted for this report have increased the amount of capital spending they plan to do during the next six months, and fewer than one in 10 have reduced planned capital outlays.

RETAIL

Nearly all of the Third District retailers contacted for this report indicated that sales declined during late September and remained sluggish in early October. For most of the stores surveyed, year-to-year comparisons in the first half of October were flat to down in current dollars. A slow sales pace was reported across most lines of merchandise, and clothing sales at department stores and apparel stores were particularly poor. Some merchants attributed the disappointing sales performance to unseasonably mild weather, but most believe a weakening in consumer confidence is reducing store traffic and sales as well. As a result of lower than anticipated sales, store inventories were high. In general, retailers have not yet expanded price reductions to move fall goods, but some indicated that they would consider doing so if colder weather did not eventually stimulate sales of fall clothing.

Retailers said the outlook for the fourth quarter was becoming dimmer. Few expect a strong holiday sales season. Merchants believe consumer confidence is being held in check by concerns about the economy and the international situation. Many store executives said diminishing prospects for stronger sales growth were prompting them to trim operating budgets and reduce capital spending plans for the balance of this year and 2003.

Auto dealers in the region said sales fell during September and the decline continued into October. Although some manufacturers' incentives have been extended, dealers expect further slowing in sales this year.

FINANCE

Outstanding loan volume at Third District banks has increased modestly in recent weeks. The gain has come primarily from real estate and consumer lending. Almost all the banks contacted in mid-October reported continuing strong growth in residential mortgages, for both refinancing and purchases. Consumer lending at area banks has picked up slightly after a relatively flat period. Business loan totals have barely edged up. In general, banks in the region have not seen much deterioration in credit quality in their commercial loans, but several noted recent increases in consumer loan delinquencies.

Bankers in the Third District expect overall lending to advance slowly through the rest of the year. Continuing growth in mortgage lending is providing most of the impetus, and bankers expect this to persist as long as mortgage interest rates remain low. Bankers expect slow growth in consumer lending, but they are uncertain about the course of business lending.

Nondepository lending institutions continue to compete aggressively with banks for business loans, but investment companies have been experiencing declining revenues as asset totals and investment activity have fallen. Employment at investment companies has been declining, and capital spending at these firms has been postponed.

SERVICES

Temporary and permanent employment agencies in the region reported a very slight increase in demand for workers in September and early October. The employment agencies indicated that hiring has picked up at firms in a variety of industries that have had recent increases in the volume of their current operations, rather than from firms adding employees to expand or initiate new lines of business. Employment agencies do not expect much increase in demand during the balance of this year, but several of those contacted for this report said they have been receiving a growing number of inquiries from firms considering stepped up hiring next year.

Some computer service firms reported a slight increase in business, especially from companies in the pharmaceutical and consumer goods manufacturing industries and from banks. Information technology companies that serve government clients also reported a pickup in business, with some of the increase coming from demand for systems projects related to homeland security measures.

Contacts in the telecommunications industry have seen no rebound in a generally downward trend of business. They do not expect capital spending in the industry to turn up for several quarters, and they anticipate only a slow recovery in capital spending once it begins to increase.

FOURTH DISTRICT – CLEVELAND

Contacts characterized economic activity in the Fourth District during September and the first two weeks of October as "slowing," "stagnating," or "declining." Industries that had reported positive conditions in the previous report (residential construction, trucking and shipping, and automobile and home goods manufacturers) noted either slowing growth or no change in conditions compared with August. Industries that reported mixed or declining conditions in the last report (retail, commercial construction, banking, and manufacturers not related to automobiles or home goods) noted further deterioration in conditions. Agriculture contacts reported conditions worse than have been seen in the area for more than 30 years. Most contacts mentioned that uncertainty regarding both domestic and international events was having an adverse effect on their businesses.

Optimism about the balance of 2002 appears to have dissipated. Most contacts expect business to remain flat through the end of the year. The exceptions are auto dealers and commercial builders, who expect activity to fall in the fourth quarter.

Labor is in plentiful supply, as headhunters and temporary agencies reported an increase in people looking for work. Contacts reported no plans to hire additional staff, but no new layoffs, either.

Manufacturing

Contacts in the manufacturing sector reported stagnant conditions through September and the first two weeks of October. Most reported that conditions in September were flat compared with August but that production and sales were still showing year-over-year growth. Some contacts reported slowing sales due to the West Coast ports' lockout. Manufacturers are cautious in their outlook for the remainder of the year – most believe conditions will remain flat.

Some automobile manufacturers in the District continued to report overtime being worked at their plants, but the amount appears to have decreased since the start of September. Two major plants in the District reported temporary shutdowns – one halted production because of the West Coast ports' lockout, while the other did so to adjust inventories in response to weaker-than-expected demand.

Steelmakers reported weak demand for their products in September and during the first two weeks in October. Production has slowed at most plants throughout the District. Some contacts noted that declining demand has resulted in price competitions as companies cut their prices. Most expect spot prices for steel will fall significantly before the end of the year. In the stainless steel industry, contacts noted that prices are 2 percent lower than at the start of the year.

Retail Sales

For the second consecutive report, Fourth District retail sales have faltered. Retailers believe that the uncertain international environment, shaky consumer confidence, and the declining stock market all contributed to the poor conditions.

Most contacts reported that year-over-year, September 2002 sales were down as much as 10 percent compared with September 2001. With the exception of discount retailers, who reported year-over-year sales increases around 3 percent, contacts were surprised that sales this year were poorer than in 2001, given the lost sales due to the terrorist attacks last year. Mall traffic the last week of September was down roughly 10 percent year-over-year. Apparel sales continue to be very weak. As has been the case for several months, however, furniture, electronics, and other big-ticket home items continued to sell well.

District retailers' outlook has become increasingly pessimistic. Contacts noted that they expect some fall-out from the West Coast ports' lockout. While a few retailers increased their inventories in anticipation of the lockout, others resorted to shipping their goods by air when the lockout began, resulting in increased costs. One firm made no changes with the onset of the lockout, and, as a result, reported that its inventories will be delayed 3-4 weeks. In general, contacts do not expect much improvement in retail conditions during the holiday season.

Automobile retailers also noted slowing conditions in September and slowing October sales as well. Contacts reported that sales have become extremely dependent on dealer incentives. Most believe the slowing will persist – dealers are pessimistic about future prospects. They believe demand over the last year was high because of incentives and that sales will be depressed in the near future.

Construction

Little has changed since the start of September for district homebuilders. Customer traffic and sales are reportedly steady and at the high monthly levels recorded last quarter. Although some contacts reported a slight decline in customer traffic at the beginning of September, the change was not persistent. Homebuilders continue to offer incentives.

Commercial builders reported unfavorable conditions for the fourth consecutive report. Competition remains fierce for the few commercial projects that are up for bid. Although there is some demand for medical and institutional structures, demand for office and industrial construction is especially weak. The outlook in the industry has become increasingly dark: Contacts reported that the architects with whom they typically work (whose projects are an indicator of future work for builders) are unable to find work.

Trucking and Shipping

Shipping activity showed no increase from the last report, but contacts continued to characterize demand as strong. Most companies imposed a price increase in late summer that has held through the second week of October, and contacts believe the higher prices will remain intact. The increase in prices did result in higher profit margins for most companies in September, but some contacts fear this may be only temporary, as diesel prices and insurance costs continue to rise.

Less-than-truckload carriers, who had reported slower year-to-date growth in their niche than the industry as a whole, noted stronger activity in September and the first two weeks of October. The uptick is attributed to the bankruptcy and exit of a major competitor from the market.

The West Coast ports' lockout resulted in more business for airfreight carriers. The industry is operating at full capacity, as retailers have begun shipping lighter, high-profit items (such as upper-end apparel and electronics) by air to keep their shelves stocked. Contacts expect this boost to be temporary, lasting only until normal shipping activity through the ports resumes.

Banking

The number of mortgage-related (first, second, and refinancing) applications for consumer loans remained extraordinarily high in the favorable interest rate environment, but the volume of applications for other consumer and commercial loans remains depressed. Competition for commercial loans to small- and mid-sized companies is increasing as demand continues to fall. Lending activity to large corporate firms held steady, but remains soft. Contacts noted a disinclination among most customers to open new lines of credit or use existing ones, given current uncertainties in both the domestic and international environments. Among both commercial and consumer loan applicants, credit quality is deteriorating.

Regarding existing loans, some contacts reported an increase in mortgage loan delinquencies and foreclosures. Others reported that commercial customers were current on their payments but that payments to their customers were being stretched out to 60-90 days delinquent.

Agriculture

Problems for District farmers persist. Some contacts reported that economic conditions are worse than they have seen in the last 30 years. Local prices for grain commodities are currently above the government assistance price floors, but yields are of poor quality and considerably lower than historical averages (some farmers reported yields that are as much as 75 percent below average).

Livestock farmers are also facing tough conditions, as they are forced to purchase winter feed at higher prices and in larger quantities than usual. The prices of cows and hogs are well below the cost of production in some areas.

For the most part, farmers are remaining current on their loan payments, but most are only making the minimum payment and, as a result, their loan principals are ballooning. Agricultural lenders noted that most farmers will rely on government, insurance, and disaster relief payments to avoid bankruptcy.

FIFTH DISTRICT–RICHMOND

Overview: Economic growth in the Fifth District remained moderate in September and October, tempered by declining manufacturing output and sluggish retail sales. Manufacturing shipments, new orders, and employment fell in September, extending a pullback that began the previous month. In general, activity in the services sector expanded at a somewhat quicker pace but growth in retail sales remained spotty. Home sales continued to increase, as mortgage interest rates trended downward, but leasing activity in the District's commercial real estate sector was flat. Price inflation remained in check throughout the District's economy. In agriculture, crop harvesting was underway, but the prolonged drought led to lower yields in most areas.

Retail: Retail establishments in the Fifth District gave mixed reports on their sales growth in recent weeks. Several large department stores in the Carolinas reported that sales grew slightly faster, while retailers in the Tidewater area of Virginia noted little change in sales. In contrast, a contact at a builders' supply chain with stores throughout the District reported slower sales due to consumers' skittishness about the national economy. Automobile dealers told us that sales were mixed. An automobile dealer in Richmond, Va., reported record sales in recent weeks, and a Washington, D.C., car dealer said sales increased as a result of pricing incentives. Dealers in other localities, however, said that their sales declined. Fifth District dealers reported no negative effects from the lockout at West Coast ports.

Services: Services firms reported moderately higher revenues and a pickup in employment in the weeks since our last report. Freight companies said demand increased and several noted that the port closings on the West Coast had not affected their businesses. Healthcare services companies in Charlotte, N.C., reported a generally soft local economy, but steady demand for elective procedures. A contact at a financial services firm, also in Charlotte, said demand had picked up in recent weeks and that the company had started hiring again as a result. However, not all services firms experienced stronger demand. A financial services firm outside Washington, D.C., reported that their revenue growth remained sluggish, in part because the public was "not anxious to invest" right now.

Manufacturing: The District's manufacturing sector contracted again in September: shipments, new orders, capacity utilization, and employment all declined. Contacts in the apparel, furniture, and rubber and plastic products industries noted particularly sharp declines in shipments. Several textile and apparel manufacturers in North Carolina told us that diminished consumer confidence and a strong dollar continued to hamper sales growth, and an industrial machinery manufacturer said that September shipments fell to their lowest level in almost a year. However, there were a few bright spots in the otherwise sour reports—a producer of plastic products in North Carolina, for example, said there were "good quality" projects in hand and he expected business to pick up in the fall. Manufacturers told us they were doing little hiring and that wage growth in the industry was modest. Prices were reported to be rising at an annual rate of less than one percent.

Finance: District loan officers said that overall lending activity continued to rise in September bolstered by continued robust growth in residential mortgage lending. A banker in Greenville, S.C., said that demand for residential mortgages was "unbelievably strong" as refinancing continued apace. Another South Carolina banker told us that he expected strong residential mortgage refinancings to continue through the end of the year and he reported that he recently hired three new loan originators to handle the heavier workload. In contrast to the brisk pace of residential mortgage lending, commercial lending was sluggish, as businesses continued to shy away from borrowing in an uncertain economic environment. State government budget woes also caused a pullback in lending—a commercial banker in Richmond, Va., said that tight state budgets had resulted in some reduction in lending for highway construction projects.

Real Estate: Although the growth in home sales slowed somewhat in several areas of the District, residential real estate activity remained generally upbeat since our last report. A real estate agent in Richmond, Va., reported a "very active" housing market and noted that his agency's sales in September were 60 percent higher than a year ago. A realtor in Washington, D.C., said September sales were about 70 percent higher than a year ago and added that overall real estate activity remained "very, very strong." He said that while houses in his area were staying on the market a little longer now, he still had more buyers than inventory, even with rising home prices. But some signs of cooling began to appear. An agent in Timonium, Md. reported that job losses and economic malaise had made people reluctant to "venture out and buy." In addition, an agent in Richmond, Va., said that homes in the uppermost price ranges had stopped selling. There were signs that growth in the Greensboro, N.C., market had slowed as well; a realtor there suggested that layoffs in the textiles and furniture industry had taken the edge off the market.

Fifth District commercial realtors reported generally flat leasing activity in recent weeks. A contact in Raleigh, N.C., noted that when it came to leasing, "the word on the street was slow and cautious." Vacancy rates edged higher in all commercial segments, though the increase was smallest for retail space. Reflecting soft demand, rental rates edged lower across all markets and landlord concessions became more commonplace. A realtor in Columbia, S.C., reported that property owners had become "more open to negotiations in recent weeks." On a brighter note, realtors in Raleigh, N.C., and Northern Virginia reported a smattering of build-to-suit projects in the industrial and retail markets. Contacts from both sectors noted that the space was procured for local, not national clients.

Tourism: Tourist activity continued to be mixed in September. Contacts from both coastal and mountain areas told us that bookings for the Columbus Day weekend were stronger than a year ago. A hotelier at Virginia Beach said that the increased popularity of family reunions since September 11 had boosted business in her area. In contrast, a contact on the Outer Banks of North Carolina said that bookings had slowed and that tighter purse strings had led tourists to rent smaller vacation homes. Several tourism industry contacts also said that businesses were more discriminating in spending entertainment dollars. Looking ahead to the winter ski season, a manager at a resort in Virginia warned that the persistence of drought conditions and water restrictions might hamper snowmaking and limit ski operations this winter.

Temporary Employment: Contacts at temporary employment agencies reported that the demand for workers continued to strengthen since our last report, and they expected this trend to continue for the next few months. Agents across the District said their clients expressed an ongoing need for additional workers, particularly with the holiday season approaching. Contacts in Columbia, S.C., and in the

Maryland/Washington, D.C., area said that the economies in their areas were improving, and they expected demand for workers to strengthen in coming months. Light industrial and administrative workers remained highly sought.

Agriculture: Drought conditions persisted in most areas of the Fifth District in September and many areas were under water use restrictions. With the exception of North Carolina, the harvesting of corn was ahead of schedule in the District. The apple harvest was underway in Virginia but apples were smaller than normal because of the earlier dry weather. Yields from tobacco, cotton, and peanut harvests in Virginia varied widely from area to area. In Maryland, soybean yields were below par due to the dry conditions. District agricultural analysts reported that low forage supplies and higher feed costs led Virginia livestock farmers to continue to cull herds.

SIXTH DISTRICT - ATLANTA

Summary: According to contacts, the Sixth District's economy continued to display sluggishness during September and early October. Retail sales were at around year-ago levels and auto sales have been disappointingly low. The strength in low- and mid-priced housing markets continued, but sales of higher priced homes remained weak in many areas, and the demand for office and industrial space continued to be lackluster. Industrial activity was generally subdued apart from the defense and automobile sectors. Contacts from the tourism and hospitality sector reported weaker than expected results for the summer. Labor market conditions were largely unchanged, while price pressures remained limited.

Consumer Spending: According to most retail contacts, sales during September were near year-ago levels. Contacts reported that competition remained intense, and discounting and promotional activities were at higher than normal levels for this time of year. Most noted that sales during September had met or fallen below their expectations. Inventories were reported to be in balance overall, although some contacts noted that apparel stocks had accumulated because of unseasonably warm weather during September and early October. Inventories were being closely monitored, and in some cases inventories were being reduced in advance of the holiday season. The majority of retail contacts anticipate that holiday and fourth-quarter sales will be flat to modestly higher when compared with last year.

By most accounts, September car sales results were lower than expected and had fallen below weak year-ago levels in some areas. Dealers reported both softer traffic and sales, particularly during the first part of September when financing incentives on 2003 models had been more limited. New car registrations in the District through August lagged the nation and were moderately below levels for the same period last year.

Real Estate and Construction: Robust District housing markets continued to benefit from low mortgage rates during September and early October. Realtors reported modest home sales growth in September, while several homebuilders noted that new home sales growth had pulled back moderately. Reports indicated that single-family home construction exceeded year-ago levels during September in most parts of the District. The strongest reports continued to come from Florida. However, the demand for higher priced homes remained weak in much of the District, and high vacancy rates and low demand for new space continued to plague commercial real estate markets. Commercial building activity was mostly limited to the public sector.

Manufacturing: Factory activity remained sluggish in September. Some firms reported modifying manufacturing processes to attain greater efficiency or were closely monitoring inventory levels in order to keep costs under control. Most business contacts indicated a continued reluctance to undertake major investments. However, Federal government defense spending was stimulating the District's manufacturing sector. Several manufacturing firms have received military contracts this year. In addition, a major shipyard was awarded a large contract for navy ships and the District's aviation sector got a boost with new military orders. Less positively, port problems on the West Coast did cause some auto producers in the region to cut back on production because of a parts shortage.

Tourism and Business Travel: Most reports from the District's hospitality and tourism sector were more downbeat than previously. South Florida tourism was unexpectedly weak over the summer months because of a larger than anticipated decline in the number of out-of-state visitors. Some resort properties in south Florida decided to close until the winter season. Business travel remained at low levels and attendance at professional conferences and seminars was down. Back-to-back storms temporarily shut casinos along the Mississippi Gulf Coast and hurt the New Orleans tourist trade during September and early October.

Financial: Consumer lending continued to increase moderately but commercial loan demand remained weak. Most contacts reported stable or growing deposits. Mortgage lending was again the largest portion of loan volume. Loan quality problems remained at moderate levels, according to most contacts. Some business contacts noted that financing for inventory accumulation purposes was unusually tight.

Labor and Prices: Most reports continued to indicate that businesses were reluctant to add to payrolls during September and early October. Some firms were reportedly meeting current production schedules by using more overtime, and increasing the use of part-time and contract personnel. Other employers were holding down costs by reducing overall staff numbers.

As before, health care costs continue to escalate and this has cut into business profits, whereas higher co-pay levels has reportedly lowered non-healthcare household spending. Steel prices remain high for suppliers in the auto industry and others. Local lumber prices slumped in early October after rallying earlier in the year.

Agriculture: Florida citrus crops and sugar production benefited from adequate rainfall and warm temperatures during September. Recent tropical storms brought needed rainfall to dry areas in the Florida Panhandle, Alabama and Georgia. However, excessive rainfall hurt the soybean crop in parts of Louisiana and Mississippi and heavy winds damaged some sugar cane fields in south Louisiana.

SEVENTH DISTRICT—CHICAGO

Summary. Reports from Seventh District contacts generally suggested that economic activity softened in September and early October. Consumer spending weakened, and many contacts noted that consumer sentiment had deteriorated somewhat. Home sales remained robust, while nonresidential activity was again weak. Manufacturers' reports indicated that the sector's activity slowed in recent weeks. Lending activity was again mixed, with strong household loan demand, but weak business loan demand. Labor markets softened somewhat as businesses were reluctant to hire. Crop conditions varied widely across the District, but forecasts generally suggested a lower overall harvest than last year. Upward wage and price pressures remained subdued for the most part, but reports of increasing insurance costs persisted. Through mid-October, the West Coast dock situation had had a limited impact on the District's economy.

Consumer spending. Consumer spending weakened in September and early October, and many contacts noted deterioration in consumer sentiment. Most retailers, including discounters, indicated that sales results failed to meet their plans, and many lowered expectations for coming months. Demand for appliances and food and consumables was said to be stronger than for other items, particularly apparel and electronics. Inventories were reportedly low, due to reduced ordering and the West Coast dock situation. Contacts in casual dining indicated that sales softened from our previous account, with the Midwest weaker than other regions. Auto dealers from around the District reported that showroom traffic and sales had decreased significantly in September and early October, from very high levels in July and August. Dealers' inventories, which had been exceptionally lean, have been building as sales slowed; as a result, one large dealer group had cut new orders for delivery in the late November period. Tourism was mixed by mode of travel; traffic remained strong at some of the District's driving destinations, but a major air carrier reported that—like business travel—tourism-related air travel was down. There were no new reports of intensifying pressure on prices at the retail level, and many contacts noted increased use of promotions, discounts, and incentives.

Construction/real estate. Construction and real estate activity continued to be strong on the residential side and soft on the nonresidential side. On balance, reports from both realtors and builders indicated that home sales remained robust through September and into October. One builders' association in the Chicago area reported significant softening in the downtown market, but another in

Milwaukee noted a pickup in new home sales in recent weeks. Some builders also reported strong traffic through models during their "Fall Festival of Homes" and said that visitors appeared very enthusiastic about buying. Builders in some markets reported that potential homebuyers had become more price conscious recently and were bargaining harder. Overall nonresidential activities remained soft, and many contacts pushed back the timetable for a recovery in commercial real estate. Office vacancy rates were unchanged in many areas; in areas where vacancy rates were still rising, they were doing so at a slower rate. Still, rents remained under downward pressure, which one contact attributed to "unusually weak demand." Vacancy rates for light industrial space continued to rise, according to contacts, keeping downward pressure on rents and leading to fewer new projects. Reports on retail development were mixed by both retail category and geography. Many nonresidential contacts noted that businesses were making inquiries, but not a lot of deals were getting done.

Manufacturing. Contact reports were mixed, but generally indicated that the region's manufacturing activity slowed in September and early October. Light vehicle demand nationwide softened in recent weeks. However, with lean inventories and a fairly optimistic industry outlook for the remainder of the year, automakers reported that no changes had yet been made to fourth-quarter production schedules. Consistent with analysts' expectations, a producer of diesel truck engines reported that the company was "reducing build schedules as fast as we can" in response to exceptionally low new orders engendered by new emission requirements. Demand for heavy equipment remained weak, although one contact noted a slight increase in agricultural equipment orders. This contact also said that heavy equipment rental companies had delayed capital expenditures for the last four years and that the machinery is aging, spurring hopes that fleet sales would improve in 2003. The machine tool industry continued to be hampered by overcapacity and a lack of capital spending. One contact described industry conditions as "the worst I have seen in 30 years," and that new orders were "bouncing along" with no real direction. A large producer of home appliances indicated that shipments slowed in August and September, after a strong July. Growth in domestic steel production slowed somewhat, in part due to increasing imports. One industry contact reported that demand for gypsum wallboard reflected the disparate strength in construction markets; residential shipments were up in the third quarter while commercial shipments were down. There were no new reports of intensifying pressure on input costs, and output prices largely remained subdued as well.

Banking/finance. Overall lending activity slowed slightly in September and early October. On the household side, refinancing activity remained very robust, with some lenders suggesting that volumes were as high as they could accommodate. While overall consumer loan quality was said to be good, some of our bank contacts noted a modest increase in delinquencies and non-accruals. Business lending remained weak. Most bankers indicated that business loan volumes were either flat or down in September and early October. In addition, many lenders noted that business customers expressed a heightened sense of caution and uncertainty. A contact with one large bank in the District suggested that businesses were "getting all their ducks in a row," but were not yet ready to borrow. Another indicated that businesses were not drawing as much on their lines of credit. According to this contact, in an expanding economy businesses typically draw roughly 70 percent of their available credit, while they are presently drawing about 50 percent. With the heightened sense of caution, many bankers did not expect to see businesses expanding, or increasing capital investments in the fourth quarter.

Labor markets. Reports on hiring activities generally suggested some softening in labor demand in September and early October. Contacts with large staffing firms indicated that new orders for temporary workers had leveled off, after trending up modestly earlier in the year. New orders for industrial workers were said to be down considerably. According to our contacts, businesses appeared unwilling to make longer-term hiring plans, with one noting that while businesses had been talking about their staffing needs for next year, "that talk has now stopped." Staffing firms reported a slight seasonal pickup in orders, a trend that was absent last year due in part to economic uncertainties resulting from the terrorist attacks. Wage pressures eased further in recent months, but employers continued to express concern over rising health insurance costs. One contact said that any merit increase for the firm's employees would likely be "eaten up" by higher health insurance contributions.

Agriculture. District corn and soybean harvests were somewhat behind last year's pace due to late spring plantings and untimely rains. Based on early October USDA estimates, Iowa's projected corn yields look much better than they did in September. Nonetheless, for the region as a whole, corn output is still projected to be down slightly from last year's harvest. The soybean forecast was unchanged, still calling for a sizeable decrease from last year. Observing poor yields, a contact in Illinois commented that local economies will face stress next spring when farmers face increased difficulty paying off operating lines of credit.

Eighth District - St. Louis

Summary

The Eight District economy has shown signs of improvement since the last report. Several manufacturers report an increase in orders and production over last year, with plans for new investment in technology and expansions. The services industry continues to grow, with activity picking up in freight hauling. Retail and auto sales have leveled off in October, and some retailers foresee the need to offer future incentives. Residential sales and construction continue to increase in the District. The commercial real estate markets appear to have improved moderately in some locations. Commercial construction, however, remains slow. Loan demand at small and mid-sized District banks was up in the third quarter, particularly for real estate loans. In the agricultural sector, recent storms had mixed effects, damaging some crops but benefiting pastures. Harvest conditions for several crops are reported to be lagging last year's pace.

Manufacturing and Other Business Activity

Manufacturing in the Eighth District continues to recover. Manufacturers in the copper, steel cable, tool, plastics, gift-wrap, recycling, hydraulics, and aluminum industries have announced plans for moving to the District, expanding business, or investing in technology. Several of these contacts note an increase in orders and production over 2001. Reports from the food and auto parts industries are mixed, with some contacts noting an increase in business and expansion while others are consolidating and laying off. While reports of layoffs are few, some manufacturers note that they will hold off on new hiring.

A few electric energy plants in the District have halted construction, anticipating weak prices in the near future and an increased need for cash flow. Contacts note that freight hauling has picked up considerably and that sales of heavy trucks are strong. A few logistics and distribution companies have announced plans to expand operations in the District. After strong sales in September, several auto dealers report that sales of new automobiles have tapered off in October. Discount retailers in the District continue to have stronger sales than general retailers. Reports from clothing retailers indicate slow sales and low traffic. Several retailers expect to offer sale discounts to excite customers. Business owners continue to voice concern over the rising cost of health care insurance, which is pushing up labor costs.

Real Estate and Construction

Contacts indicate that, primarily due to historically low interest rates, home sales are up in most of the District, with the exception of northeast Mississippi, where sales are down. Mortgage activity is also high, with many people refinancing and first-time home buyers entering the market. In northern Arkansas housing is still in high demand as a result of people moving into the area. In Memphis, condominium sales are at an unprecedented high, up from their year-to-date level. Home sales are also high in Memphis, with those in the moderate and move-up price segments selling the best. In more than half of the District's metropolitan areas, monthly and year-to-date housing permits have increased. According to the Home Builders Association of Greater St. Louis, September marked the third month this year that builders crossed the 400-home mark, compared with only one month in 2001. In Memphis, most residential construction activity is for houses priced under $150,000. Residential construction has been strong also throughout rural western Tennessee.

In St. Louis, contacts note that there is positive absorption in the industrial market, especially for bulk space, and that there is a trend in the office market toward newer, better buildings. In Memphis, positive absorption rates indicate that the commercial real estate market is doing relatively well, as newly occupied space has increased in net terms. Despite the improved market for commercial real estate, commercial construction remains weak. In Memphis and St. Louis, in particular, contacts report a slowdown in the market. In Little Rock, however, commercial construction was good this summer, but not as good as the summer of 2001. Private construction is picking up slowly in Louisville, where government construction remains good.

Banking and Finance

Total loans outstanding at a sample of small and mid-sized District banks are up, with an increase of 3.4 percent between mid-July and mid-September this year. Real estate loans stand out as the largest contributor to this increase, with a rise of 4.1 percent. Commercial and industrial loans decreased slightly, by 0.5 percent. Loans to individuals and other commercial banks in the United States rose modestly by 0.6 percent and 0.7 percent, respectively. The total deposits at these banks were up slightly by 1.1 percent over the same period.

Agriculture and Natural Resources

Agricultural conditions are mixed. In the Delta region, an abundance of rainfall and strong winds produced by tropical storm Isidore and hurricane Lili in late September and early October have curtailed rice and cotton prospects. While it is too early to assess the damage to these crops, contacts report deterioration in the quality of the crops in many cases. These same rains, however, have been beneficial to pastures that were in mostly poor-to-fair condition throughout the District.

The corn crop harvest in the southern portion of the District is virtually complete while the harvest in the northern portion is behind last year's pace in all states except Missouri. The harvest of the District's soybean crop is also behind 2001 levels in all states except Missouri and Tennessee. Similarly, the harvesting of cotton, rice, and tobacco all lag last year's pace. Corn and soybean yields, hurt by a lack of moisture during critical periods this summer, are expected to be lower in most District states.

This fall producer cash flows could be squeezed by a decline in government payments under the new farm law, as counter-cyclical payments for grains or oilseeds are unavailable because projected prices exceed the benchmark level. In contrast, cotton and rice farmers can now request government payments because prices for their crops will be below the benchmark level.

NINTH DISTRICT--MINNEAPOLIS

Ninth District economic activity during September and early October was slow. Consumer spending was weak, and energy and commercial construction activity were down. Agriculture and mining were mixed, while manufacturing, residential construction and tourism grew. Over this period labor markets were soft. Overall, price and wage increases were modest, but significant price increases were noted in trucking and insurance.

Construction and Real Estate

Commercial construction was down. The value of contracts awarded for new construction projects in Minnesota and the Dakotas decreased 8 percent for the three-month period ending in August compared with last year. Representatives of commercial real estate firms said that recent leasing activity declined, with much sublease space available in the Minneapolis-St. Paul area, and sale prices for new office buildings are soft in Minneapolis-St. Paul compared with last year. Commercial and heavy construction in Montana was down from a year ago, according to a bank director. Recent commercial construction in the Fargo, N.D., area has been steady, although not as robust as a year ago, according to a member of a local economic development organization. However, solid buying activity was noted in the Minneapolis-St. Paul industrial market.

Activity in home building and residential real estate was solid. The number of planned units in the Minneapolis-St. Paul area was 26 percent higher in September compared with a year ago, primarily due to strong growth in multifamily housing projects. However, the vacancy rate for apartments in the Minneapolis-St. Paul area increased to 5.2 percent during the third quarter, up from 2.5 percent a year ago. A bank director reported strong recent home construction activity in southwest Montana; however, several construction firms noted reduced bidding activity for 2003 projects.

Consumer Spending and Tourism

Overall consumer spending was weak. A major Minneapolis-based department store retailer reported that overall same-store sales were down about 1 percent for September compared with a year ago. A food distributor and grocer in the Minneapolis area reported that shoppers are purchasing more low-cost grocery items compared with premium food products.

District mall managers reported soft sales for September. Traffic and sales at a Minneapolis area mall were down in the low single digits in September compared with a year ago. Another Minneapolis mall reported sales down about 5 percent in September from a year ago due to recent expanded local retailer competition. Sales at a North Dakota mall were down during the first week of September compared with a year ago; however, they rebounded during the rest of the month.

Recent auto sales were steady to down slightly from the previous report, according to representatives of auto dealer associations. In North Dakota, sales were steady in September, while in South Dakota a majority of dealers reported good September sales, but October started slow compared with late summer. Car and truck sales in the Minneapolis-St. Paul area were soft in September, but trucks were selling well in other parts of Minnesota.

Fall tourism activity was solid in several parts of the district. A South Dakota tourism official in the Black Hills area reported tourism-related visits and sales up 12 percent to 15 percent in September compared with a year ago. Visits to Mount Rushmore were on a record-setting pace. Fall tourism traffic and inquiries were on par with a year ago, according to a chamber of commerce official in northwestern Wisconsin. However, in the Upper Peninsula of Michigan, some tourism businesses predicted that the year will finish lower than 2001.

Manufacturing

Manufacturing activity was slightly up. A September survey of purchasing managers by Creighton University (Omaha, Neb.) indicated level manufacturing activity in Minnesota and some increased activity in the Dakotas. An early September survey of manufacturers in Minnesota, jointly conducted by the state Department of Trade and Economic Development and the Federal Reserve Bank of Minneapolis, revealed that manufacturers expect orders to increase in the second half of 2002 from the weak first half of the year. In North Dakota, a wind turbine blades manufacturer reported strong demand for its wind energy products, while a construction equipment manufacturer announced plans to shut down production for one week in October. In Minnesota, a maker of snowmobiles recently announced plans to expand a factory. However, a telecommunications plant in Minnesota is expected to close.

Energy and Mining

Activity in the energy sector declined, while the mining sector was mixed. Mid-October district oil and natural gas exploration and production levels were down from early September. Meanwhile, an iron nugget pilot plant in northern Minnesota received a $5 million boost from the U.S. Department of Energy. However, a large Montana platinum and palladium mine scaled back its production forecasts.

Agriculture

The agricultural economy was mixed. Livestock producers felt the negative effects from the drought and lower hog prices. Meanwhile, crop producers received firm prices, and Minnesota and North Dakota producers enjoyed healthy crops. The U.S. Department of Agriculture (USDA) rated 55 percent and 59 percent of the pasture feed rangeland in Montana and South Dakota, respectively, as poor or very poor. Meanwhile, the USDA estimated large sugar beet and dry edible bean harvests in Minnesota and North Dakota. The USDA rated 72 percent of the Minnesota corn and soybean crops as good or excellent. The USDA reported that preliminary September corn and wheat prices were up 8 percent and 12 percent, respectively, from August. However, the preliminary September price for hogs was down 17 percent from August.

Employment, Wages and Prices

Labor markets loosened slightly since the last report due to layoffs. A major Minnesota-based airline recently called for as many as 1,600 flight attendants to go on voluntary leave for one month to a year and announced plans to lay off 63 pilots by February. A national trucking company went bankrupt, eliminating 260 drivers in Minnesota. A St. Paul-based computer software company recently announced plans to shed 234 jobs. A call center in Minnesota will likely close in December, affecting 200 jobs. A South Dakota sewing plant recently announced plans to shut down, affecting 45 employees. Employment levels in district states dropped for the 14th straight month in August.

In contrast, a national bank announced plans to add 120 full-time jobs at its St. Cloud, Minn., facility during the coming year. A retailer in Sioux Falls, S.D., plans to hire as many as 700 new employees during October for a new store.

Wage increases were moderate. Wages for district manufacturing workers increased less than 2 percent for the three-month period ending in August compared with a year ago, the smallest increase in over 10 years. A Minnesota city employees' union ratified a new contract that provides a 3 percent increase in pay each year for two years.

Increases in prices were also reported as moderate, with the exception of significant price increases in trucking and insurance. A Montana bank director noted modest increases in overall prices. Trucking rates recently increased about 6 percent to 8 percent from a month earlier, according to a representative of a major trucking company. In 2003, family health insurance costs will increase by 20 percent and 38 percent, respectively, from 2002 at two large Minnesota companies.

TENTH DISTRICT - KANSAS CITY

Overview. The Tenth District economy slowed somewhat in September and early October, but business contacts remained cautiously optimistic about future activity. Consumer spending fell slightly, manufacturing activity eased, and energy activity edged down. Commercial real estate markets showed no improvement, and the farm economy continued to suffer from drought conditions. On the positive side, housing activity remained solid in much of the district. Labor markets remained soft, with wage pressures subdued. Retail prices were flat, while prices for some manufacturing materials continued to edge up.

Consumer Spending. Retailers in the district reported slightly weaker sales in September and early October than in previous months. Sales on a year-over-year basis were also down marginally. Unseasonably warm weather depressed sales of fall and winter apparel, in particular. Some merchandise categories, however, including home furnishings and electronics, remained relatively strong. Store managers were generally satisfied with inventory positions and plan to build stock levels as usual in preparation for the holiday season. Although some managers expressed concern about continued economic uncertainty, most anticipate solid sales in coming months. Following a strong August, motor vehicle sales declined sharply in September and early October. Outside of Colorado, however, vehicle sales in the district were still slightly higher than a year ago. Auto dealers generally expressed more uncertainty about future sales than other types of retailers, and some were ordering fewer new models than in past years. In the tourism industry, leisure travel activity was solid in most of the district and was particularly strong at the national parks in Wyoming.

Manufacturing. District factory activity eased slightly in September and early October. After rising during much of the year, production and new orders edged down, pushing capacity utilization rates lower. In addition, both actual and planned capital spending fell considerably after improving somewhat during the summer months, with most plant managers citing weak demand for their products as the reason for reducing expenditures. Despite these signs of weakness, plant managers continued to express optimism about future production levels. Aside from some delays caused by the dock workers' strike, managers reported few difficulties obtaining materials other than steel.

Real Estate and Construction. Residential real estate activity in September and early October was solid in most of the district, while commercial real estate markets remained weak. Building activity was steady in most areas, although single-family construction slowed somewhat in Denver, Colorado Springs, and Tulsa. Most builders expect similar levels of home construction in coming months. Home sales also remained solid except in Tulsa and much of Colorado. Home prices were flat or rose only slightly throughout the district. Realtors anticipate some improvement in home sales in the few areas where sales have been weak, and they expect steady sales elsewhere. Mortgage lenders reported another sizable increase in demand for home loans, primarily for refinancings. In contrast to the previous survey, lenders reported that more of the recent refinancing activity was for the purpose of reducing monthly payments than for taking cash out. Mortgage demand is generally expected to level off in coming months. Commercial real estate activity weakened further in Denver and showed no improvement in other district cities. Office vacancy rates remained higher than a year ago throughout the district, and most realtors reported their market was overbuilt. Commercial realtors in some markets expect further deterioration in coming months, as more tenants vacate space.

Banking. Bankers reported that loans fell and deposits edged up since the last survey, reducing loan-deposit ratios. Demand increased for home mortgage loans but fell for commercial and industrial loans, residential construction loans, and commercial real estate loans. Demand for home equity loans was little changed overall, with some bankers reporting increased demand due to low interest rates and others reporting decreased demand due to cash-out refinancings. On the deposit side, all categories edged up except large CDs, which held steady. All respondent banks left their prime lending rates unchanged, and most banks also held their consumer lending rates steady. A few banks tightened their lending standards, citing weak economic conditions.

Energy. Energy activity in the district fell slightly in September and early October, but is expected to rebound this winter. The count of active oil and gas drilling rigs in the region declined somewhat from levels reached during the summer. However, energy prices have risen recently and district contacts expect natural gas prices to hold these gains, leading to increased drilling activity in coming months.

Agriculture. The district's farm economy continued to suffer from drought conditions in September and early October. Nonirrigated corn and soybean crops suffered significant damage, and producers will have to rely heavily on crop insurance payments. However, irrigated crops were average, and producers should benefit from high commodity prices. The drought also eroded pasture conditions, forcing some district ranchers to sell cattle early or reduce their breeding herds. District feedlots face losses due to low prices and limited feed supplies. Despite the difficulties in agriculture brought on by the drought, district farmland values have held firm.

Wages and Prices. Wage and price pressures remained subdued across the district in September and early October. Labor markets were quite slack, with employers still having few difficulties filling all but the least desirable positions. Layoff announcements in the district began to pick up in October after subsiding in August and September, suggesting that softness in labor markets will continue. Wage pressures remained virtually nonexistent across the district, but many employers continued to express concerns about rising health care premiums. Retail prices were flat in September and early October and are expected to remain stable through the rest of the year. Manufacturers reported that finished goods prices edged down, while prices for some materials, particularly steel, continued to rise. Plant managers expect finished goods prices to continue to fall slightly, and they anticipate further modest increases in materials prices. Builders reported steady prices for materials, and do not foresee any changes in the near future.

ELEVENTH DISTRICT—DALLAS

Overall Eleventh District economic activity showed signs of contracting in September and early-October. Manufacturing activity declined, and retailers reported slower than expected sales. Construction and real estate conditions remained weak, with continued softening in the market for single-family homes. There was no change in financial services activity, and energy activity has not increased with higher oil and natural gas prices. Agricultural conditions have been favorable.

Contacts were significantly more pessimistic about the outlook for growth through the rest of the year, citing concerns about war, terrorism, the dock-worker's strike on the west coast, declining stock market and upcoming elections. This widespread uncertainty is leading consumers spending and business investment to be put on hold, they say.

Prices and Labor Markets. Price pressures are mixed. Contacts continued to report high and rising prices for all types of insurance. Prices are up for energy products, including diesel fuel and heating oil. Crude oil prices have also increased over the past few weeks. U.S. inventories are below normal and were cut further by storms that recently struck the Gulf Coast. Contacts believe oil prices are carrying a war premium of roughly $5. High oil prices have pushed natural gas prices upward. Despite near record inventories, natural gas prices remained over $3.50 per mcf for most of the period—25 percent higher than last year.

Price declines were also reported. Retailers say selling prices have dropped over the past few weeks. Home prices have also fallen in some areas. Contacts in the temporary service industry report downward pressure on wages. Chemical producers said the series of price increases for plastic products have come to an end and, for some products, there is pressure for price reductions.

Manufacturing. Manufacturing activity declined, and weakening was widespread across the industries in the sector. Demand for paper products, which has been slowing over the past few months, accelerated its decline over the last month. Apparel producers say demand continued to be slow. Demand for construction-related products continued to soften, although public works projects helped maintain sales levels of concrete, cement and fabricated metals. Sales of processed food products were up over the last month, however, which contacts suggest is due to consumers staying at home rather than going to restaurants.

The slow improvement that had been reported in the high tech industry over the summer has dissipated in the past few weeks. Demand has improved for components that go into some consumer products, such as cell phones and personal digital assistants. But personal computer demand remained weak, and contacts say the fight for market share is stiff. Layoffs continue, particularly in the telecommunications industry.

Demand for petrochemicals has flattened. Poor profits and growing inventories of heating oil led refiners to cut back production along the Gulf Coast. Hurricane Lili briefly closed a number of refineries and stopped crude deliveries to the region.

Services. Legal firms say activity has slowed from last quarter but remains stronger than a year ago. Litigation, bankruptcy and commercial lending activity remained strong, but transactions activity was weak to nonexistent. Demand for temporary services continued to slowly improve. Demand is strongest to supply administrative, clerical and call centers, while the tech, financial, and light industrial sectors are still sluggish.

Demand for transportation services is still very weak. Airlines reported that the conditions in the industry are bad and getting worse, as the airlines try to adjust capacity to meet demand. The carriers with labor union contracts reported the most difficulty, because they are unable to lower fixed costs fast enough. Leisure travel over the holidays looks promising they say, but business travel is very weak and there are no signs of a rebound. Trucking firms say demand is 30 percent below a year ago.

Retail Sales. Retail sales softened. Stores reported slower than expected sales growth or a decline in sales compared to a year ago. Contacts had expected to easily match and exceed last year's depressed September sales and were shocked that sales were below a year ago. Many retailers expressed serious concern that nothing had really changed to precipitate slower demand and have revised down their expectations for sales. Automobile sales have softened in recent weeks and are expected to be 10 percent to 15 percent lower than two months ago.

Financial Services. Overall activity remained flat. Deposit growth was strong, which respondents attribute to increasing amounts of money moving from the stock market to bank accounts. Overall lending activity was unchanged. Mortgage refinancing continues to grow, but contacts reported a recent slowing in auto and consumer lending, particularly for credit cards. Charge-offs and delinquencies are described as relatively stable.

Construction and Real Estate. Construction and real estate conditions remained weak. Contacts say activity in the single-family market has tapered in the last six weeks, although incentives and low interest rates continued to spur sales of lower priced homes. Multifamily leasing activity deteriorated in Austin and Dallas. Office vacancy rates continue to rise and rent concessions are widespread. Public projects remain a source of strength.

Energy. Drilling activity has not responded to higher oil and natural gas prices or expectations for a seasonal increase. Contacts blame the lack of drilling activity on record high natural gas inventories and fears that the current high prices for both oil and natural gas are temporary. International drilling activity also remained flat. Oil service firms say they expected the current downturn to be short and resisted staff reductions. As the downturn persists, however, there is increasing pressure for layoffs.

Agriculture. Production conditions have been favorable. The Texas cotton harvest is expected to be significantly larger than last year, but export demand remains weak. Producers are optimistic that they will get another cutting of hay this month.

TWELFTH DISTRICT–SAN FRANCISCO

Reports from Twelfth District contacts indicate that economic activity grew modestly in September and early October. Upward price and wage pressures remained muted overall. Sales of automobiles and smaller retail items slowed a bit, and service providers reported mixed conditions across sectors. Demand for most manufactured items remained weak, due in part to limited spending on capital equipment; however, orders and sales for some products, such as semiconductors and pharmaceuticals, grew further. Agricultural contacts noted good yields and sales for most crops. Although some agricultural producers faced increased shipping costs due to the recent work stoppage at West Coast ports, the effects of the work stoppage on other sectors were limited. Demand for commercial real estate remained soft, and home sales cooled a bit in some areas but remained at very high levels. Financial institutions saw continued weak demand for business loans but strong household loan demand, spurred largely by mortgage refinancing.

Prices and Wages

Reports indicate little upward pressure on prices and wages in the most recent survey period, with the notable exceptions of rising prices for health care and shipping services. The prices of many retail products and services reportedly were flat to down, with steep discounting reported in some cases. Wage increases were limited in all areas by ample availability for most types of labor. By contrast, most businesses continued to adjust to rising costs of health insurance, with a significant portion of the increase passed on to employees. The labor dispute and consequent work stoppage at West Coast ports led to increases in the prices of alternative shipping modes, although these increases are likely to be temporary, pending a return to normal port operations.

Retail Trade and Services

Demand for retail items weakened somewhat in September and early October, and service providers faced mixed but generally soft demand. Automobile sales slowed somewhat despite continued favorable financing terms. Demand for smaller retail items fell a bit further compared to the previous survey period; large discount chains continued to outperform department stores and specialty retail outlets, but sales reportedly weakened in all market segments. Travel demand was sluggish in most areas, with occupancy and room rates reportedly below normal. In Hawaii, domestic tourist counts were above normal (based on levels measured prior to last year's terrorist attacks), but this was more than offset by low counts of international tourists. Somewhat weak demand for trucking services was exacerbated a bit by temporary disruptions in service caused by the work stoppage at West Coast ports. Business consultants and Internet connectivity providers saw very weak demand, with further closures by the latter reported in the Pacific Northwest. By contrast, demand for medical laboratory services continued to grow, and advertising companies benefited from a temporary demand surge associated with election season political campaigns. Spending on capital equipment remained at low levels for most retailers and service providers, but a few reports indicated increased spending on computer software.

Manufacturing

Manufacturing activity was somewhat sluggish overall during the survey period. Semiconductor producers saw a further modest pickup in demand, with capacity utilization rising and prices firming somewhat in recent weeks. However, orders and sales for other manufactured products were soft, with especially weak reports provided by makers of telecommunications equipment, commercial aircraft, and machine tools. Demand for durable manufactured products was held down by weak spending on capital equipment, with companies in all sectors of the economy exhibiting reluctance to spend beyond the minimum needed for maintenance of their existing equipment base. Among makers of nondurable products, clothing manufacturers reported little or no growth in orders. By contrast, producers of pharmaceuticals reported continued solid demand growth. The recent work stoppage at West Coast ports disrupted some manufacturing supply chains, although the impact on overall manufacturing activity was negligible.

Agriculture and Resource-related Industries

Demand for agricultural and resource-related products grew in the survey period, although adverse supply conditions affected performance in some sectors. Yields and sales of fruits, vegetables, and nuts were high, and inventories were maintained near desired levels. Overseas demand for District crops was solid, spurred in part by the weakened dollar, but some agricultural producers incurred excess storage costs because the work stoppage at West Coast ports prevented the timely shipment of perishable products to customers abroad. Moreover, cattle ranchers faced high feed and grazing costs that prompted herd liquidation at low sales prices. Contacts reported that electricity supply conditions were adequate to meet demand and keep prices stable in the near term.

Real Estate and Construction

Demand for commercial real estate remained weak, while home sales were rapid but a bit slower in some areas compared to the previous survey period. In most areas, vacancy rates for commercial and industrial space reportedly have stabilized at high levels and commercial construction activity remained quite depressed; healthy demand conditions were reported only for parts of Southern California. By contrast, residential demand remained robust throughout the District, with especially rapid sales growth reported for Hawaii, Southern California, and the Sacramento area. However, the pace of sales and price appreciation fell in some other areas, most notably in Utah. The pace of new home construction also was high in most parts of the District but fell a bit in some areas.

Financial Institutions

Financial institutions reported mixed loan demand and credit conditions. Weakness in business loan demand persisted, and lenders competed for low risk loans in several District markets. By contrast, low interest rates spurred further growth in home mortgage refinancing and kept overall household loan demand high. Banks reported strong deposit growth, but credit quality was somewhat mixed, with increasing delinquencies and loan defaults in some markets.