The Federal Reserve Board

January 15, 2003

Summary of Commentary on Current Economic Conditions by Federal Reserve District

Summary

Prepared at the Federal Reserve Bank of San Francisco based on information collected before January 7, 2003. This document summarizes comments received from businesses and other contacts outside the Federal Reserve System and is not a representation of the views of Federal Reserve officials.

Reports from the twelve Federal Reserve Districts indicated subdued growth in economic activity from mid-November through early January, with little change in overall conditions relative to the last survey period. Most Districts characterized growth as "sluggish" or economic activity as "soft" or "subdued." The weakest report came from Dallas, where economic activity "remained anemic." As in the last survey, conditions in the New York, Philadelphia, and Cleveland Districts were more favorable overall than in other Districts, with each, especially New York, describing various signs of improvement.

Reports on consumer spending were consistently weak, with disappointing holiday sales that, in nominal terms, mostly were at or below last year's levels. Automobile sales surged at year-end in response to favorable sales incentives. Manufacturers expanded production a bit on balance, with notable gains for defense-related and biomedical products. Providers of nonfinancial services saw little change in existing weak demand, and business travel remained slow, although there were some reports of improved performance in the tourism sector. Home sales and residential construction activity remained at high levels but slowed a bit in some areas, and the widespread overhang of commercial real estate persisted. Agricultural production was hampered by adverse weather in some areas and performance was mixed. Extraction activity in the energy sector responded very little to sharp increases in energy prices. Bank lending continued to expand in most Districts due to strength in consumer and real estate borrowing. Labor demand was mostly flat, and despite rising costs for employee benefits and some inputs, increases in employee compensation and final prices were held down by competitive supply conditions.

Consumer Spending
Most Districts reported disappointing retail sales revenues during the survey period, with holiday season spending that was flat or down a bit compared with spending in the previous year. In Cleveland, sales were "very poor," with most respondents reporting declines of 1 percent to 10 percent from year-earlier levels; San Francisco reported "lackluster" sales that were "well below [retailers'] expectations." Most other Districts saw flat sales, although Richmond and Minneapolis noted scattered reports of solid sales growth, largely due to strength in post-Christmas purchases. A relatively short holiday season and inclement weather in some areas played small roles in holding sales down.

In most areas, sales were stronger at large discount chains than at traditional, higher-priced department and specialty stores. Consistent with these observations, substantial discounting on holiday retail sales items was reported in all Districts, with Chicago explicitly noting deeper discounting compared with a year earlier. New York and Philadelphia reported moderate accumulation in retail inventories, but other Districts reported generally balanced inventories, due to a combination of conservative planning and the dominant role of low prices rather than low sales volume in determining weak nominal sales revenues.

Among product lines, the strongest holiday sales were recorded for consumer electronics and toys. Automobile sales showed signs of weakening in some areas, but according to Philadelphia, Cleveland, and Chicago, favorable year-end financing and price incentives produced a sales flurry in late December, lifting overall sales to high levels for the survey period.

Manufacturing
The manufacturing sector continued to struggle with weak demand and excess capacity, although, on balance, slight improvement was evident. The strongest report came from New York, where manufacturers statewide reported increases in new orders, shipments, and hours worked and were "overwhelmingly optimistic" about the near-term outlook. Overall activity was flat to up slightly in most other Districts. However, Kansas City reported weakened activity in December after signs of stabilization earlier, and St. Louis reported widespread announcements of employment cuts among manufacturers of durable and nondurable products.

Demand for high-tech products was flat or improved a bit in Dallas and San Francisco, with the latter reporting increased sales of semiconductors for use in wireless technologies. Boston, Atlanta, Kansas City, and San Francisco cited sales gains for pharmaceuticals, medical equipment, and defense-related equipment. Manufacturing activity increased slightly in the Minneapolis District, with expanding capacity and production levels reported in the heavy machinery, metals, and electronics sectors. Automobile manufacturers in the Cleveland and Chicago Districts faced mostly stable demand, with a sales surge at the end of the year helping to bring inventories down from November's excessive levels. Declines in construction-related manufacturing were reported in Chicago and Dallas, and Richmond reported weak demand conditions for apparel manufacturers.

Most Districts reported little or no increase in capital spending by manufacturers. Atlanta noted declining demand for capital goods, and Kansas City indicated that capital spending fell in December after having firmed in October and November. Looking ahead, Philadelphia reported that the number of firms intending to boost capital spending in the first half of 2003 fell recently, and capital spending among manufacturers in the San Francisco District is being held down by excess capacity that is expected to persist for six months or more at the current pace of expansion.

Nonfinancial Services
Demand for business and professional services was somewhat weak and, overall, exhibited little change from the previous survey period. Philadelphia and Richmond described overall demand for services as "flat" or "steady." Dallas noted slow demand for accounting and legal services, and in the San Francisco District demand for advertising and related media services was soft. Boston reported good sales and revenues for insurance companies but noted that poor investment results kept hiring and capital spending frozen. Demand for trucking services remained strong in the Cleveland District despite a slowdown in December that was larger than the usual seasonal lull, and St. Louis reported steady demand for trucking but uneven profits due to rising fuel costs. Relative to seasonal norms, hiring or planned hiring of temporary service workers was slow in Philadelphia, Richmond, and Dallas. By contrast, New York reported "brisk," broad-based hiring of temps in December.

Performance indicators in the travel and tourism sector were mixed. New York reported higher hotel occupancy and room rates compared with a year earlier. In the Atlanta District, hotel bookings in tourist areas have climbed back near their levels from the year 2000, although convention business in Atlanta has been hampered by persistent weakness in business travel. Atlanta and Richmond indicated that travelers are delaying travel plans to an unusual degree, and New York noted that recent figures on advance ticket sales for Broadway theaters were running 15 percent below a year earlier. Because of favorable weather conditions, early season ski receipts were excellent in the Richmond, Kansas City, and San Francisco Districts. However, Richmond reported weakened tourism in coastal areas, and Minneapolis reported sparse snow and a slow start to its winter sports season. In the San Francisco District, hotel occupancies have returned to normal in Hawaii but have been low elsewhere. Demand for airline services generally remained weak, although Dallas noted that holiday travel for some airlines was better than expected.

Real Estate and Construction
Residential construction activity and home sales remained at high levels in most Districts, although there were numerous reports of slight cooling in market activity. Reported activity was strongest in the Richmond District, where growth in home sales remained strong and the housing market was described as "tremendously active." Market activity was down somewhat in the Boston, New York, Cleveland, Chicago, Kansas City, and San Francisco Districts, due in part to normal seasonal slowing. St. Louis indicated that home demand may be leveling off. In Atlanta, home sales fell in December after an increase in November. Construction activity was at "low levels" in the Dallas District, although lower-priced homes (below $250,000) sold "briskly." Boston, Atlanta, and Chicago also reported stronger demand for mid- and entry-level homes and condominiums than for more expensive residences.

The markets for commercial real estate continued to exhibit substantial slack in all Districts. Richmond and St. Louis described demand for office and industrial space as "sluggish" or "slow," while office vacancy rates increased slightly in Minneapolis-St. Paul, the city of Chicago, and parts of the Kansas City District. In the Cleveland District, commercial building activity remained at low levels, but builders reported a significant increase in the number of prospective projects. Minneapolis reported low vacancy rates for retail space and a corresponding increase in planned retail construction. Although San Francisco reported a decline in office vacancies in Los Angeles, contacts from that District and Dallas expect little overall change in commercial construction activity over the next two years.

Agriculture and Natural Resources
Agricultural output and performance was mixed across Districts, as adverse weather conditions hampered agricultural production activity in some areas. Chicago reported high yields and high prices for a variety of crops. There and in the St. Louis District, the value of farmland rose markedly, and bankers in the Kansas City District reported good credit quality for their farm loan portfolios. San Francisco noted improved sales of agricultural products, due in part to increased overseas demand spurred by the weaker dollar. By contrast, Minneapolis reported deterioration in performance in the agricultural sector. Moreover, heavy rain and otherwise inclement weather limited yields and production activity for a wide variety of crops in the Richmond, Atlanta, Chicago, and Dallas Districts, while lack of moisture is likely to limit yields for the winter wheat crops in Minneapolis and Kansas City.

Activity in the energy and mining sectors was flat or up slightly on net. Mining activity in the Minneapolis District continued at high levels. Minneapolis and Kansas City reported no change in extraction activities for oil and natural gas, and Dallas reported only a slight increase, despite a sharp rise in the prices of oil and natural gas. In addition, Dallas noted that inventories of natural gas and crude oil were well below year-earlier levels.

Financial Services and Credit
Loan demand was up on net, mainly reflecting strength in consumer and real estate lending. Business loan demand remained somewhat depressed in the Cleveland, Richmond, Chicago, and San Francisco Districts, and it fell further in Dallas. Kansas City reported a slight weakening in all loan categories and tightened credit standards. By contrast, Philadelphia reported modest increases in all categories. Contacts in New York and St. Louis saw a pickup in commercial and industrial loans, with New York reporting tightened credit standards for that category. Household loan demand remained strong in most areas, especially for home financing. However, household loan demand fell a bit in Atlanta, and both demand and quality were quite weak for household loans in Dallas.

Employment and Wages
In most Districts, firms remained very cautious in their hiring decisions and most categories of labor were in ample supply. Continued layoffs in a variety of industries were reported in several Districts, most notably St. Louis and San Francisco. The labor market in New York was described as "slack" overall, despite a reported increase in hiring of temporary services workers. Among Districts, only Minneapolis reported some tightening in labor markets. In Cleveland, labor markets were "stable." Upward wage pressure was described as "subdued" in Chicago and Kansas City and restrained by a weak labor market in San Francisco. Minneapolis reported modest wage increases (about 2 percent) compared with a year earlier, and Boston noted that some firms plan to ease restrictions on pay increases in 2003. Kansas City noted that the only categories of labor in short supply were health-care workers and some construction tradesmen, and Atlanta reported double-digit yearly wage increases for hospital workers. Contacts in Atlanta and Minneapolis cited sharp increases in employer costs for employee health coverage. Chicago and San Francisco reported that firms are responding to increased health costs by passing on a portion to employees through rising direct contributions or reductions in other components of compensation.

Prices
Despite rising costs for energy and other inputs, upward movement in the prices of final goods and services was quite limited. Chicago noted rising input costs for steel, packaging, and electronic components, but pointed to "fierce competition" as the main factor holding down prices for final goods. Kansas City also pointed to rising materials costs for manufacturers, although it noted that steel prices fell recently and prices of finished goods continued to decline. Several Districts reported a sharp increase in fuel costs in December. As noted by Dallas, however, stiff competition limited the impact of rising energy costs to reduced profit margins on some intermediate goods rather than increased prices of final goods.

Return to top

First District--Boston

The First District economy remains soft, but business contacts appear to be somewhat more confident that they can cope with a period of slow activity than they were earlier in 2002. Most New England manufacturers report no increase in demand for their products. Retail respondents indicate sales were below expectations in the October-December period. Residential real estate markets are slowing but perhaps only seasonally. Insurance companies cite gains.

Retail
First District retailers report mostly flat sales in October, November, and December compared to the previous quarter. Many contacts' results are lagging behind their forecasts, most of which were revised downward earlier in 2002 as expectations of an economic turnaround diminished.

Home furnishing retailers experienced a pickup in sales in November, but sales weakened through December; the timing of the holidays and the weather are said to be among the causes of the slowdown. An electronics retailer continues to experience soft sales, while an office supply store indicates sales are steady. Wireless, digital, and imaging products are reported to have sold well this quarter. A high-end shoe retailer says sales were strong in first quality retail stores, while outlet stores failed to meet expectations. Lumber and home building suppliers, in a seasonal lull, experienced mixed fourth quarter results, as low lumber prices continue to hinder profits. Auto sales are slower, as is typical at this time of year. However, car sales in 2003 are expected to be disappointing compared to 2002.

Most retailers are keeping inventories tight, but some auto dealers report inventories are slightly higher than anticipated. Overall, capital spending is limited to required IT upgrades and purchases. With the exception of two contacts who cut their headcounts 5 percent or less, retailers say employment is steady. Wage increases, where they are occurring, are reported to be minimal--below 3 percent. The more optimistic retail contacts do not expect sales to pick up until the third quarter of 2003, while others see no signs of improvement.

Manufacturing and Related Services
First District manufacturing contacts report few if any signs of a pickup in demand for their products in late 2002. Most makers of capital goods and other business products indicate that business remains soft. Their sales are generally flat to down slightly from a year ago. Despite a pickup in Pentagon spending, overall demand for aircraft and parts remains considerably below year-ago levels. A manufacturer of pharmaceutical and biotech equipment reports continued growth, albeit at a rate that falls short of earlier expectations. A maker of specialized machine tools cites an increase in orders, but the industry as a whole is continuing in a slump. Makers of consumer products indicate that holiday sales were either "okay" or fell short of expectations.

Selling prices remain under competitive pressure. Contacts increasingly mention competition from foreign suppliers, particularly Chinese, which they expect to be a long-term phenomenon. Nevertheless, some firms indicate that they will attempt to raise selling prices in an effort to cover higher costs for items such as insurance, plastics, and steel.

Most manufacturing contacts say they are reducing employment or holding it steady, although some are cautiously undertaking selective hiring. Several firms report plans to ease restrictions on pay increases in 2003, resulting in merit raises in the range of 2 percent to 4 percent.

Capital spending plans for 2003 are mixed. Some respondents indicate that weak demand, excess capacity, and profit pressures will result in curtailments relative to earlier plans. However, others report some "loosening of the purse strings," including capital spending initiatives to increase productivity.

Manufacturers are anticipating that conditions will improve somewhat in 2003. Some say that their business results could exceed their conservative projections, barring unexpectedly severe shocks to the economy emanating from international events.

Residential Real Estate
New England contacts report slowdowns in several markets, but there is no consensus as to whether the change is seasonal or the markets "have started to soften." Lower-end homes and condominiums continue to sell quickly and at close to their asking prices. Higher-end homes stay on the market longer. As a result, inventory of higher-priced homes has begun to build up, but some contacts continue to report lack of inventory, especially at the entry level. Although a few markets have experienced modest price declines, most contacts report that selling prices remain stable so far. Double-digit price appreciation in Massachusetts, seen throughout most of 2002, is likely to slow down, as sellers realize that their asking prices are "no longer realistic." Single-family home sales in Massachusetts did not change much in October or November, but because of robust sales earlier in the year, 2002 is likely to be the strongest year in the state's history. Most contacts expect residential markets to be slower in 2003, but do not foresee drastic deterioration, as long as interest rates remain low.

Insurance
Respondents in the insurance industry report strong financial results, combined with continuing rate increases for the fourth quarter of 2002. Companies in the property and casualty sector continue to see strong demand and robust revenues, as rates are up 12 percent to 25 percent from 2001. While most firms remain unaffected by the economy's slow recovery, uncollectible receivables from the manufacturing sector are becoming a source of concern. Low interest rates and weaker investment performance have also put pressure on earnings, resulting in downward revisions to capital spending and employment, effectively freezing hiring. Nevertheless, contacts say the short- and long-term outlook remains positive as they anticipate strong sales.

Life insurance providers report strong results in traditional life insurance despite rising compensation costs and flat product pricing. Employment remains level and capital budgets are static. Providers of disability insurance report higher levels of disability claims; these together with low interest rates are squeezing profits. Revenues are slightly below target, with a consequent slowdown in planned capital spending and hiring. According to most respondents, the risk of war with Iraq creates demand uncertainties, as clients in troubled sectors may further cut spending. Apart from external risk, respondents expect gradual growth similar to that in last quarter.

Return to top

Second District--New York

The Second District's economy has been mixed since the last report with weakness in retail sales and some easing off in the housing market but with signs of a pickup in manufacturing and some stabilization in commercial real estate. Retailers mostly indicate that holiday and post-holiday sales were below plan; both selling prices and merchandise costs were described as steady to lower than a year ago, but retail inventories were said to be at manageable levels.

Manufacturers and purchasing managers indicate steady to improved activity in recent weeks and steady to lower prices. Port traffic is also described as strong. Housing markets and construction activity have shown further signs of slowing in recent weeks, especially at the upper end of the market, though the general level of activity remains robust. New York City's office market showed signs of stabilizing in the final two months of 2002, though rents were sharply lower than at the end of 2001. Finally, bankers report increased demand for commercial loans and nonresidential mortgages, tighter lending standards in those same categories, and steady to lower delinquency rates.

Consumer Spending
Most retailers report that holiday sales in the district were disappointing. Sales were particularly sluggish during the first half of December and, sales for the month as a whole were mostly below plan. Some contacts note that unit sales were roughly on plan but that dollar volume was reduced by steep discounting. Most major department store chains report that same-store sales were down moderately from a year earlier, though discount chains fared somewhat better. Separately, based on a trade association's annual survey of small retailers across New York State, holiday sales were little changed from comparable 2001 levels. Post-Christmas sales were hampered by a snowstorm that blanketed most of the District.

Apparel sales were generally described as weak, except for outerwear, which was buoyed by unseasonably cold and wet weather. Sales of home furnishings were described as mixed. Some retail contacts say that inventories are in good shape, while others described them as a bit high but manageable. Most retailers report extensive discounting, particularly in the final two weeks of the month, and virtually all say that selling prices, as well as merchandise costs, were steady to lower than a year earlier.

Regional surveys of consumers indicate steep declines in confidence in December. The Conference Board reports that confidence in the Middle Atlantic region, which had rebounded from a cyclical trough in November, gave back almost all of that gain in December, falling nearly six points. Similarly, Siena College's monthly survey of New York State residents showed confidence slipping again in December--particularly in the New York City area, where confidence fell to a cyclical low.

Construction and Real Estate
Residential real estate markets have shown mostly weaker signs since the last report. New York City's co-op and condo market has shown further signs of slowing in the fourth quarter. A major Manhattan realtor reports that sales volume in recent weeks was down moderately from a year earlier and estimates that selling prices on these mostly high-end properties have slipped 10 percent to 15 percent from their peak levels last spring. This contact also notes that there are more properties on the market than a year earlier, particularly at the high end, and that buyers respond to price reductions. A leading residential appraisal firm also reports some slowing in the New York City market in the fourth quarter, but notes an uptick in transactions in December, with prices flat to rising at the lower end of the market but flat to declining at the upper end.

Housing permits in New York and New Jersey retreated in October and November. Both single-family and multifamily permits slipped for the second consecutive month, though both remain at a fairly strong level, especially multifamily. In New York City, more units were authorized for construction in 2001-02 than in any two-year period since 1973-74. An industry contact in New Jersey attributes part of the recent slowing to much colder and wetter weather than in recent years but maintains that demand continues to outstrip supply and that there is no evidence that prices have peaked, except at the high end of the market.

Manhattan's commercial real estate market showed signs of stabilizing in November and December--Downtown Manhattan's vacancy rate declined, while Midtown's rate edged up. Asking rents continue to run more than 10 percent lower than a year ago. An industry contact notes that the low rents Downtown are drawing or keeping more firms in that neighborhood and have contributed to slackening in some of the suburban markets, such as Jersey City, Westchester, and Fairfield County, Connecticut.

Other Business Activity
A major freight terminal reports that shipments through the Port of New York and New Jersey have continued to run at extremely strong levels, despite the resolution of the West Coast dockworkers strike. Similarly, surveys of manufacturers and purchasing managers point to steady to improved conditions in the region's manufacturing sector at year-end. Buffalo-area purchasers report little change in business conditions in December, with an increase in production activity but declines in new orders and hiring activity. However, purchasing managers in the New York City area report fairly widespread improvement in manufacturing sector conditions in December, but significant weakening in other sectors. Separately, partial results of our latest survey of New York State manufacturers, conducted in early January, indicates continued gains in activity--both shipments and new orders continued to rise, though unfilled orders declined; the number of employees remained steady but the average workweek increased. Respondents also report some leveling off in input prices and increasingly widespread declines in selling prices, but remain overwhelmingly optimistic about the near-term business outlook.

Tourism activity has held relatively steady in recent months. Hotel occupancy rates and room rates were little changed in November and both were moderately higher than a year earlier. While statistics for December are not yet available, an industry contact reports that business was reasonably good. Separately, Broadway theaters report that advance ticket sales for January and February are running 15 percent below last year, and that many theaters are offering larger discounts and promotions to attract customers.

A contact in New York City's securities industry estimates that bonus payments will be down 35 percent from last year, and expects that employment will decline further in the current quarter. However, he notes that industry revenue edged up in the fourth quarter for the first time since early 2000, and indicates that most firms are not contemplating further layoffs. More generally, while the labor market is still characterized as slack, a major New York City employment agency notes brisk activity in office temp hiring in December, with demand fairly broadbased across industries.

Financial Developments
Bankers at small to medium-sized Second District banks reported higher demand for nonresidential mortgages and commercial and industrial loans, along with a seasonal decline in demand for consumer loans. Demand for residential mortgages was little changed, following widespread increases in the last three surveys. Bankers reported no change in overall refinancing activity over the past two months.

On the supply side, bankers reported tighter credit standards for nonresidential mortgages and especially commercial and industrial loans--in particular, 35 percent of bankers reported tighter standards for the latter, with no bankers reporting an easing of standards. Credit standards for consumer loans and residential mortgages remained unchanged. Loan rates declined for all types of loans, particularly residential mortgages, for which 80 percent of bankers report lower rates. Widespread declines were also reported on deposit rates. Lenders report lower delinquency rates for consumer loans by a more than two-to-one margin, but relatively stable rates in other categories.

Return to top

Third District--Philadelphia

Business conditions in the Third District were mixed in December. Manufacturers reported slight gains in new orders for the month compared with November. Retail sales of general merchandise during the Christmas shopping period barely matched the prior year's level, overall, and some stores had year-over-year declines. Auto sales were steady during most of December at around the same pace as in November, but they picked up near the end of the month. Bank lending was moving up at the turn of the year, with modest growth in the major credit categories--business, consumer, and residential real estate loans. Companies in the service sector generally indicated that the pace of business has not changed significantly from earlier in the fall. According to the companies' reports, demand for business services has been flat, and firms in the service sector have been limiting their expansion plans.

The outlook in the Third District business community is muted. Contacts in all industries are concerned that economic conditions, especially labor markets and consumer confidence, are fragile. Manufacturers forecast some increases in shipments and orders during the next six months. Their capital spending plans are positive, on balance, although the number of firms scheduling increased expenditures has slipped recently. The outlook among retailers is varied; some store executives anticipate flat sales during the first half of the year, but a few expect slight gains. Auto dealers expect a lower sales rate in 2003 than in 2002. Bankers generally expect overall loan demand to rise slowly in the next few months, mainly as a result of some growth in consumer lending. Service companies expect some gains in business by the second quarter of the year, although they are uncertain about the timing and strength of the improvement.

Manufacturing
Third District manufacturers reported a slight gain in new orders, on balance, in December but an easing in shipments. Overall business conditions appear to have changed little since November, with firms in most of the region's major manufacturing sectors generally reporting steady activity or sluggish growth. Order backlogs were flat in December compared with November, and delivery times decreased, suggesting that demand for area firms' products is not pressuring production capacity. Most of the manufacturers contacted in December indicated that prices for both the inputs they use and the goods they manufacture were steady during the month, and many firms continued to report strong price competition in their industries, especially from Asian companies.

On balance, the region's manufacturers forecast better business conditions in the first half of 2003 despite the fact that many said they had not seen the improvement they had expected in 2002. Just over half of the firms surveyed in December expect increases in orders and shipments during the next six months, while slightly more than one in ten anticipate decreases. Area manufacturers' capital spending plans call for increases, on balance, but compared with plans reported earlier this fall the number of firms that intend to boost spending in the first half of 2003 from current rates has slipped and the number that plan to trim spending has increased.

Retail
Third District retailers gave mixed reports for the Christmas shopping period, with nearly equal numbers of stores matching, exceeding, or falling below their results of a year ago. The best sales by type of good were toys, inexpensive jewelry, and some lines of apparel, such as outerwear and casual clothing. Some retailers noted that shoppers showed a stronger preference for these traditional gift items this season compared with past years, and bought fewer items from other merchandise lines, such as housewares and sporting goods, for gifts. Several merchants reported that sales per customer were down even though store traffic appeared to be normal for the season, and one retail contact noted that shoppers spent less than usual amounts on incidental purchases while they shopped for gifts. With sales generally failing to meet their expectations, most of the retailers contacted for this report said their inventories were high, although few said they were far above acceptable levels.

Most of the retailers contacted for this report expect sales to move up slowly at best through the first quarter of the year, but a significant portion of those surveyed anticipate no improvement until spring. Third District merchants are virtually unanimous in their views that consumer confidence is not strong and that shoppers will continue to limit purchases and look for discounted prices on all the goods they buy.

Auto dealers reported steady sales for most of December at about the same rate as in November. Sales turned up near the end of the month as manufacturers stepped up incentives, but dealers anticipate a return to a slower pace, and they expect lower sales in 2003 than in 2002.

Finance
Outstanding loan volume at Third District banks was moving up as 2002 came to a close. Bankers generally reported gains in business, consumer, and real estate lending, although most said that growth has been modest. Bank lending officers continued to describe the commercial and industrial loan market as competitive. Some noted a slippage in commercial credit quality, but most of those contacted for this report said delinquencies have not increased materially.

Deposit growth has continued to be strong for many banks in the District, which bankers attribute to depositors looking for low-risk savings opportunities. But with only small gains in lending recently, bankers continued to be concerned about compression in interest rate margins. Some bankers also said they think depositors might be quick to withdraw funds if confidence in other types of investments is restored.

Bankers in the Third District generally expect overall lending to grow slowly as the new year gets under way. They expect moderate gains in consumer lending and steady or slowly rising real estate lending. Opinions on the likely path of business lending were mixed. Some bankers believe the recent slight increase in demand for business loans will be short-lived, while others believe it might signal the start of a trend of more steady, albeit slow growth.

Investment company activity has been essentially flat in the past two months, according to contacts in the industry who said low investor confidence continues to hamper growth in equity investing, although money flows into bond funds have continued. Investment in money market funds has been limited in the low interest rate environment, but is expected to pick up if rates rise.

Services
Most of the service firms contacted for this report indicated that conditions have not changed materially from earlier in the fall. Some law firms have noted increased business, but in general, demand for business services has been nearly flat. Several business services firms noted that their activity levels usually move in tandem with employment in the region, and that the lack of growth in employment has limited their own ability to expand. Contacts expect business to begin moving up by the second quarter of 2003, but they have seen no evidence of imminent improvement.

Temporary and permanent employment agencies in the region reported an unexpected slippage in hiring plans for the first quarter of 2003. Although the firms for which they provide workers plan to increase staffing levels on balance, the number of firms that intend to hire additional workers appears to have edged down compared with the number that added employees in the last quarter of 2002, even after allowing for seasonal hiring patterns.

Return to top

Fourth District--Cleveland

According to reports gathered from December 23 through January 3, the Fourth District's economy continued to show mixed signals during the last six weeks of 2002. Although some deterioration in conditions was noted among contacts in the nondiscount retail, automotive retail, steel, and banking industries, it appeared that more contacts saw flat conditions or slight improvement. Both homebuilders and trucking and shipping contacts reported continued favorable conditions in their industries. Commercial builders, for the first time in more than a year, reported signs that improvement may come with the new year, and most manufacturers appeared cautiously optimistic that new orders and conditions would pick up in the first quarter of 2003.

That said, uncertainty over the economic outlook remains in the Fourth District. Many contacts seemed to expect flat conditions for 2003 only because they were not sure how geopolitical risks and equity markets would affect consumer confidence and their customers' willingness to spend money. Other contacts, however, particularly in banking and commercial construction, seemed to note cues from their business customers that slight optimism was emerging regarding 2003 prospects.

Labor conditions were stable, although some firms reported difficulty in finding qualified managers. Other than seasonal adjustment of labor forces in retail, very few labor changes were expected among District companies.

Manufacturing
Reports from the manufacturing sector showed more consensus in this report than in the last. Most contacts reported that production remained fairly constant in November and December (adjusting for holidays); sales in December 2002 were above both November 2002 and December 2001 levels; input prices, with the exception of steel (which is falling), were stable; and inventories were down year-over-year and at acceptable levels. Most reported no changes in their labor force. Some reported excess capacity. In general, manufacturers of home- and automotive-related goods reported more positive conditions than other manufacturers. Most contacts appeared mildly optimistic about prospects for 2003, with none expecting a decline in conditions and some expecting an increase in both production and sales compared with 2002.

District auto plants reported fairly mixed conditions--roughly half the models produced in the District showed an increase in production in the first three weeks of December compared with the first three weeks in November 2002, while the other half showed a decrease. This was also true when comparing production for the first three weeks of December 2002 with the same period in 2001. Overall, however, 2002 production in the District was higher than 2001 production for all but one company. None of the plants reported temporary closures in the last six weeks of 2002, but one reported that it ended production of one of its model lines in December.

Steelmakers reported that demand softened yet again in December and noted that while some of the decline in demand was seasonal, part of it was because their customers had built their raw-materials inventories when prices began rising. Demand is expected to remain soft during the first quarter, due to an oversupply of steel in the industry. Prices, which fell roughly 20 percent in Q4:2002, were expected to continue falling in Q1:2003.

Retail Sales
Contacts in retail reported that sales in November and December were flat to down compared with one year ago, and, compared with historical averages, very poor. Contacts reported sales for the period from Thanksgiving to the week before Christmas were down between 1 percent to 10 percent from the year before, although some of this decline was due to the short holiday season. Nondiscount stores reported heavy promotions, and though the volume of merchandise sold was comparable to years before (resulting in lean inventories), total sales in dollars were significantly down for stores, especially among apparel retailers.

Contacts noted some pickup in sales during the week of Christmas and the following week but did not expect the pickup to persist. Most contacts expected sales for Q1:2003 to be flat but did not have solid expectations beyond the first quarter, citing uncertainties in the geopolitical environment and wavering consumer confidence as reasons they could not make projections for sales in 2003.

Although auto dealers in the District saw a slight increase in sales during the last week of November and the last week of December due to manufacturers' incentives, most reported sluggish sales for the last two months of 2002. Inventories among auto retailers were climbing--most dealers try to keep a sixty-day supply on their lots, but contacts reported inventories ranging from seventy-day to more than one hundred-day supplies. Although sales slowed considerably in Q4:2002, overall sales for 2002 were expected to be above historical averages, though not as high as 2001, which was a record year. Looking forward, contacts expected the level of sales in 2003 to be flat or slightly lower than 2002 levels.

Construction
Although there has been some seasonal slowing in residential construction over the last six weeks, District homebuilders reported that conditions remained stable and that 2002 sales were slightly above their projected plans. Commercial builders, on the other hand, continued to report weak conditions. In a change from most of their reports in 2002, however, commercial construction contacts reported that the number of prospective projects has increased significantly. The increase did not appear to be sector-specific, and some of the projects were "noncritical," suggesting that businesses are beginning to contemplate spending dollars on capital projects other than those strictly for maintenance and upkeep.

Trucking and Shipping
Trucking and shipping activity remained strong throughout November. Although contacts expected a seasonal slowdown in December, the slowdown was more pronounced than they had expected. Volume was expected to remain flat until spring, when the seasonal pickup in shipping from auto manufacturers and their affiliated companies occurs.

Despite slowing demand, excess capacity in the industry remained at very low levels, and price increases continued to be reported across the industry. These price increases have not resulted in larger profits: most of the reported increases were spurred by increased costs of inputs, especially health and collision insurance costs.

Banking
Conditions in banking were relatively stable during the last six weeks of 2002, although contacts noted a narrowing of spreads because loan rates have fallen while funding rates remained relatively constant. Commercial loan demand was flat, and contacts continued to characterize conditions in commercial lending as weak. Most noted that businesses were taking a "wait-and-see" attitude regarding the economy--with increased uncertainty about equity market performance and potential war, companies are reluctant to take out loans to make major expenditures. Some contacts, however, noted that although their commercial customers were cautious, they seemed optimistic about prospects for 2003.

On the consumer side, loan demand was steady and continued to be fueled by home equity loan activity (most of which was refinancing). The number of loan applications remained steady, but contacts noted that the credit quality of applicants was very poor. Competition for creditworthy borrowers remains intense.

Return to top

Fifth District--Richmond

Fifth District economic growth remained sluggish in the weeks since our last report as modest growth in the services sector was tempered by sluggish growth in retail sales. Retail sales increased modestly in November, but growth was sluggish on balance, in December. Services businesses reported moderately higher revenues in November, but a leveling of activity in December. In manufacturing, shipments were flat and new orders showed fledgling growth in the weeks since our last report. District home sales remained exceptionally strong, but leasing in the commercial real estate sector was sluggish. Price pressures remained modest throughout the District's economy. In agriculture, above-normal rainfall slowed cotton and soybean harvesting and limited plantings in many areas.

Retail
Retailers in the Fifth District characterized pre-Christmas sales growth as relatively weak, though most contacts said that sales growth in the post-Christmas period was strong. A contact at a large department store chain with a presence throughout the District said holiday sales were "not remarkable," though he noted that this year's sales growth was about even with last year's. A department store in the lowlands of South Carolina and a big-box retailer in the Tidewater area of Virginia echoed the same theme. But post-Christmas sales were stronger than a year ago, driven, in part, by a wider use of gift certificates. Expecting additional gift certificate redemptions, District retailers anticipated increased sales for the coming two months. Outside of retail stores, automobile dealers across the District had slow sales growth in December in spite of factory incentives, but most expected sales activity to pick up in January.

Services
District services businesses generally reported "steady" customer demand since our last report. Executive search firms in Virginia, Maryland, and D.C., said client demand has been unchanged in the last four to six weeks. Having several advance bookings, a West Virginia caterer was pleased with their current business level, but expressed some apprehension about the effects of a "down economy" in the coming year. On the downside, a large nonprofit facility in Washington, D.C., said demand for childcare--their biggest service--had declined, as members looked to cut their personal budgets by finding alternatives.

Manufacturing
Manufacturing activity was steady in November and December as shipments were nearly flat and new orders expanded at a modest pace. Some plant managers saw improvement. A Maryland producer of electronic equipment reported that shipments picked up in December because of stronger orders from a large discount retailer. In addition, a manufacturer of plastic goods in South Carolina noted that his market had "cleansed itself of weaker companies" and now his firm could "put up the sail and go with the wind." In contrast, apparel and textile manufacturers saw no improvement. Contacts in these sectors reported weaker demand for their products. A manufacturer in North Carolina said that his customers were not building inventory because they expected consumer spending to remain slow. In District labor markets, manufacturing employment continued to contract in recent weeks, while average wages rose at a moderate pace. On an optimistic note, however, manufacturers reported that the workweek edged higher in December--the first growth in six months.

Finance
District loan officers said that loan demand changed little since our last report. In a familiar refrain, contacts reported that commercial lending remained generally weak. Commercial bankers said that the sluggish economy and the possibility of war with Iraq made businesses hesitant to borrow. A commercial banker in Virginia noted that borrowing by municipalities and institutions of higher education was relatively strong, but she added that demand from private sector firms had flagged. Another banker reported generally weak activity among his private sector clients, except, interestingly enough, beer and wine retailers. "People drink more in a bad economy," he surmised. Residential mortgage lenders continued to report brisk mortgage lending. A Richmond, Va., banker reported a "flurry of refinancings" in December because, he believed, people were expecting rates to tick up in the new year.

Real Estate
Residential realtors reported continued strong growth in home sales in recent weeks. A Washington, D.C., agent described that area's real estate market as "tremendously active," with home sales far surpassing year-ago levels. Likewise, an agent in Odenton, Md., said December sales were fantastic, despite the area snows that damped customer traffic through homes. She reported a low inventory of homes in the low to midpriced range--her "hottest" market right now. A Herndon, Va., agent said sales of high-end homes were good, but he noted that it was difficult to find lots on which to build homes. House prices remained generally steady across the District.

In the commercial sector, realtors reported sluggish leasing activity in recent weeks, though they attributed much of the lull to a customary seasonal slowdown. On the industrial front, a Charlotte, N.C., contact summed up conditions in the sector as "slow to partly cloudy." Demand for office space also remained sluggish across the District, but a contact in Greenville, S.C., reported that while interest in purchasing property by occupants remained low, investor interest continued to rise. The supply of vacant space across market sectors varied little from our last report. Likewise, rent levels were generally unchanged in the office and retail sectors. In the industrial market, however, contacts noted that landlord concessions were more widespread for warehouse space. Despite the holiday stall, a number of contacts voiced optimism about the coming year.

Tourism
Tourist activity was strong at District ski resorts but softer along coastal areas in recent weeks. Contacts at several ski resorts told us that colder temperatures and ample water for snowmaking allowed them to open about three weeks ahead of schedule. A Virginia operator said that bookings were about 20 percent higher than a year ago, as people wanted to ski closer to home this year. According to him, skiers were spending "like there is no tomorrow." His counterpart at a mountain resort in West Virginia also reported stronger business in December but noted that patrons were waiting until the last minute to book. Tourism in coastal areas was somewhat weaker since our last report. A hotelier in Virginia Beach said their New Year's Eve promotion did not sell out this year, unlike last year when reservations for the event were completely booked by the middle of December.

Temporary Employment
Contacts at District temporary employment agencies reported somewhat stronger demand for workers since our last report, though the pickup was centered in higher demand for seasonal retail workers. A Raleigh, N.C., agent cited retail and tourism as the primary drivers of increased hiring, but added that his agency had received a big boost in business from a dot.com client as well. While most agencies noted modest increases in hiring, several said that demand for temporary workers was lower than a year ago. However, even among those agencies, most were optimistic that business would strengthen in the new year.

Agriculture
Excessive rainfall in November and a major ice storm in December slowed harvesting activity and limited small grain planting in most of the District. In North Carolina, both cotton and soybean harvesting were behind schedule. Peanut, cotton, and soybean harvesting slowed markedly in Virginia because of the excessive precipitation. In contrast, cotton harvesting in South Carolina was virtually complete, but yields were below normal. Planting of small grains was delayed in North Carolina and Virginia because saturated fields couldn't accommodate farm equipment.

Return to top

Sixth District--Atlanta

Contacts reported that economic activity remained subdued in the Sixth District during late November and December. Merchants' sales were mixed and discounting was widespread over the holiday period. Auto sales, however, improved in December. Although single-family residential building and sales cooled a little in some areas, District housing markets posted strong figures overall, and listings were reported as balanced. Weak demand continued to plague commercial real estate markets and vacancy rates remained high. Factory activity was sluggish, with new layoffs in some sectors and slowing production in others. Reports on tourism and hospitality improved, but the business travel sector remained weak in most areas. Labor markets were lackluster, and there were few signs of significant improvement. Price increases remained limited. Heavy rains adversely affected some District crops.

Consumer Spending
Sales reports from around the District largely mirrored national reports in late November and December. Most contacts indicated that holiday sales were near last year's levels and either met or fell slightly below expectations. According to the retailers contacted, electronics and children's apparel performed well across the District, while men's apparel, jewelry, and home-related product sales were mixed. Heavy discounting was widespread and most contacts reported that fourth-quarter profit margins declined from last year. Most retailers described inventories as balanced. The majority of merchants contacted anticipated that first-quarter sales would rise modestly compared with last year's level, but also noted a high level of uncertainty about the outlook.

District car sales weakened further in November but improved in December, according to contacted dealers. A major producer reported that car and truck sales in November were off from a year earlier. Used auto sales in December were mixed, with wholesale auctions in Atlanta troubled by below-average dealer participation and high inventories. However, Florida's used car sales auctions surged in December because of strong demand from out-of-state dealers attracted by bargain offerings from fleet and lease companies.

Real Estate and Construction
District housing markets continued to benefit from low mortgage rates in late November and December. According to reports from real estate agents, the region's home sales were up slightly in November from a year ago, but the pace slowed somewhat during December. Most District homebuilders reported that new home construction during November and December was near last year's levels, while home sales were down a bit from last year. Homes priced in the midrange were in strongest demand, while high-end homes continued to be difficult to sell. Most realtors indicated that listing inventories were balanced. Many contacts noted their concern that sluggish job growth may dampen demand going forward. Weakness persisted in local commercial real estate markets in December.

Manufacturing
Overall manufacturing activity remained sluggish in late November and December. A manufacturer of capital goods reported that orders weakened in the fourth quarter. Some manufacturers, however, indicated that customers were placing orders for software systems and networks to update equipment. Production was suspended at three regional plywood-

manufacturing facilities and will reportedly not resume until lumber markets improve. Some Tennessee and Georgia vehicle manufacturers reported that inventories were undesirably high and that production would have to be temporarily cut back. On a positive note, orders for companies that make military equipment were strong, and a producer of health-care equipment reported increased new orders and was adding to payrolls.

Tourism and Business Travel
Reports from the District's hospitality and tourism sector revealed some improvement in late November and December. Business travel to south Florida improved modestly, but visitors were not booking much in advance, according to area contacts. Some reports indicated that hotel and motel bookings for the holiday period returned to near 2000 levels. Weakness in business travel persisted in Atlanta and the city's convention business continued to suffer. Central Florida theme parks were reportedly packed over the holidays. Seasonal rentals were lagging behind last year's figures because of a decline in demand from "snowbirds" from the northern United States as well as from Canada.

Banking
Reports from the banking sector were mostly positive. Contacts noted that residential mortgage lending and refinancing activity remained mostly strong in late November and December, with a few reports of slowing in some parts of the District. Solid deposit growth at District banks was attributed to the lackluster performance of the securities markets. Contacts observed an increase in the demand for commercial loan refinancing because of low rates.

Labor and Prices
Most reports indicated that holiday hiring was conservative, and that good staff was easier to find in most sectors. Turnover of seasonal help was lower than usual. However, many employers were favoring paying overtime rather than hiring new staff. Temporary employment agencies reported that business was flat to down from a year ago.

Health-care costs continued to escalate. Staff shortages were resulting in double-digit wage increases for hospital workers. Contacts reported that group health-care premiums were expected to increase at double-digit rates in 2003. There were also widespread reports of rising energy prices in December.

Agriculture
Above-average rainfall adversely affected District citrus groves and cotton fields. Florida citrus growers reported standing water in their fields and Georgia cotton producers noted that only 70 percent of the cotton crop was harvested, well behind normal levels. Also affected by stormy weather was Louisiana's sugar crop, with losses estimated to be near 10 percent and 20 percent.

Return to top

Seventh District--Chicago

Reports from Seventh District contacts generally suggested that economic activity remained soft toward the end of 2002. Consumer spending again was relatively soft, and many retailers expressed disappointment with holiday sales results. Business spending was also sluggish, and capital expenditure plans for the new year were said to be "cautious." Activity in the District's housing markets was relatively brisk, but nonresidential activity remained weak. Softness persisted in the manufacturing sector, but there were some reports of improvement in a few key industry segments. Refinancing activity continued to drive household borrowing while softness persisted in business loan demand. Upward pressure on wages and retail prices generally remained subdued, though contacts continued to express concern over rising health-care costs. Farmland values in District states were on pace to show the largest year-over-year gain since 1997.

Consumer Spending
Consumer spending remained generally soft in December. Holiday sales results were largely in line with most of our contacts' conservative plans. However, a large freight company in the District said the firm's big retail customers were "not very happy with the outcome" of the holiday shopping season. A contact in Michigan added that there were "no glowing reports" from small retailers either. Retail inventories were said to be in line with sales expectations for the start of the new year, as merchants kept their stocks leaner during the holidays than they had in previous years. Auto dealers in the region reported that new vehicle sales were weak early in December, but noted "a flurry of activity" after Christmas as consumers sought to take advantage of generous year-end incentives. Dealers' new vehicle inventories decreased modestly from November's levels, but were said to be slightly higher than desired. Used car sales reportedly softened during the month, but body shop and seasonal service receipts, which had been soft, picked up with the onset of winter weather. Cinema ticket sales continued to "do very well" in December, while casual dining sales were said to be mixed and "hard to read."

Business Spending
Contacts reported that overall business spending was sluggish in December, and that plans for the new year were "cautious." One large staffing services firm noted that demand for temporary help, particularly from manufacturing and light industrial clients, had softened toward the end of 2002. Another contact said that orders for temporary workers in Michigan had become "stagnant" in December, after showing some improvement in the fall. Business travel was said to be flat, but one contact reported that demand for trade show space in the region was good. Most contacts suggested that there was little change in business capital spending at the end of 2002. One banker summed up the general sentiment of contacts, saying that businesses were "paralyzed" by apprehension despite very favorable lending rates and terms. While many reports suggested that capital spending plans for 2003 are relatively weak, contacts indicated that those plans could change quickly once demand picks up.

Construction and Real Estate
Once again, construction and real estate activity was relatively strong on the residential side and soft on the nonresidential side. Sales of both new and existing homes slowed somewhat toward the end of the year but remained strong. Homes at the lower end of the market continued to outsell those in the upper price ranges in most areas. Some reports suggested that the number of housing units on the market increased modestly toward the end of 2002 but none of our contacts felt that inventories were excessive. Looking forward, both builders' and realtors' groups were expecting sales in 2003 to decrease slightly from 2002 but remain at high levels. There was little change in nonresidential activity according to contacts. Office vacancy rates were fairly stable in most metro areas, as space demands remained weak. One exception was Chicago's office market, where vacancy rates continued to creep up in the fourth quarter, while effective rents moved down. Chicago is one of the very few markets in the nation where a significant amount of office space is still under construction. Thus, many real estate professionals don't expect vacancy rates in the Chicago market to peak until 2004.

Manufacturing
Manufacturing activity was again relatively soft in December, but there were increasing reports of improvement in key industry segments. Demand for light vehicles nationwide surged at the end of the year, which helped bring inventories down from November's excessive levels. This prompted at least one automaker to increase first-quarter production plans, albeit slightly. A large producer of telecommunications equipment reported a modest recovery in most of their product lines. This contact added that demand in the high-tech sector was a microcosm of the overall economy, with strength on the consumer side and weakness on the business side. Producers of machine tool parts noted that requests for price quotes and sales picked up slightly in December. In contrast, manufacturers of heavy equipment reported little improvement as 2002 drew to a close. A contact with one large producer of gypsum wallboard suggested that production slowed notably in December, mostly due to weakness in commercial construction markets.

Banking and Finance
Favorable financing rates continued to buoy household lending activity, while business loan demand remained soft. Strength on the consumer side was again driven by mortgage refinancing activity. One lender in the District indicated that growth in mortgage lending was limited only by the bank's capacity to process applications. Contacts said that there was little discernible change in consumer loan standards or quality in December. Bankers generally indicated that business loan demand remained soft. One large bank reported an uptick in small business loans and another noted a modest increase in applications for business credit lines (although customers were reluctant to draw on them). However, contacts suggested that these isolated increases may have been due to shifts in market share rather than a general improvement in loan demand. Bankers contacted reported no change in business credit quality.

Prices and Employment Costs
Upward wage pressures remained subdued and largely unchanged in December. However, many contacts suggested that increasing health insurance costs were further stressing their bottom lines. Employers more frequently were shifting portions of these increases to their workers in an effort to contain costs. There were a few reports from manufacturers of rising input costs (such as for steel, packaging, and electronics), but increases in output prices were said to be constrained by fierce competition. Fierce competition reportedly kept prices in check at the retail level, as most retailers reported deeper discounting this holiday shopping season than a year earlier.

Agriculture
According to our survey of rural bankers, farmland values in District states in the third quarter of 2002 increased an average of nearly 7 percent from a year earlier, and were on pace to show the largest year-over-year gain since 1997. Farmers in the western and northern portions of the District have benefited from bumper crops and markedly higher corn and soybean prices. However, adverse weather in much of Illinois and Indiana reduced crop output and contributed to increased financial stress on portions of the industry in those states.

Return to top

Eighth District--St. Louis

Contacts indicate that economic activity in the Eighth District softened in recent weeks. In manufacturing, reports of plant closings, layoffs, and cutbacks have increased. Retailers report that holiday sales were below expectations despite heavy discounting; the reduced consumer spending was attributed to a shortened shopping season, bad weather, and a weak economy. Home sales are still up in most of the District, and commercial real estate markets continue to be sluggish. Loan demand at small and midsized District banks rose in the fourth quarter of 2002.

Manufacturing and Other Business Activity
In the Eighth District's manufacturing sector announcements of plant closings, cutbacks, and layoffs has risen since our last report. Manufacturers in the electrical, apparel, furniture, ventilation, auto parts, paper and packaging, lighting, mobile homes, steel, and aluminum industries are among those who have announced plant closings and layoffs. Contacts note that problems faced by the manufacturing sector include fewer and smaller orders, low selling prices of products, increased international competition, and an uncertain economy. A few firms, however, still plan to move to or expand within the District.

Early reports of retail sales indicate that most retailers' expectations for holiday spending were not met, despite heavy discounting. Purchases by post-Christmas bargain-hunters may help increase profits but are not expected to close the gap appreciably. Though they continued to fare better than general retailers, discount stores also saw holiday sales fall below expectations. Among the strong sellers were toys, entertainment, and home items, while adult apparel did not sell as well. Contacts attributed the reduced consumer spending to a shortened shopping season, inclement weather in some parts of the District, and a weak economy. Several contacts note that retailers will continue discounting merchandise. Contacts in the trucking industry report that demand is steady, although fluctuations in fuel prices are affecting profit margins. The increasing cost of health-care insurance, driving up labor costs, continues to be a concern across all industries.

Real Estate and Construction
Residential real estate sales are still up in most of the District. Home sales in the Memphis area were higher in October 2002 compared with the same month last year. Contacts in St. Louis and Louisville report that the real estate market is still steady but leveling off. Home sales are still strong in Evansville. November year-to-date permit levels were higher than the previous year's levels in most of the District's metropolitan areas. In Louisville, housing starts continue to be strong for first-time homebuyers in the $100,000-$130,000 range. Housing starts are booming in the Fayetteville area. In rural western Tennessee, residential contractors report having plenty of work.

Commercial real estate markets continue to be sluggish in most of the District. Memphis reported negative absorption in the third quarter of 2002, with abundance of sublease space and increasing vacancy rates. In Louisville, the midyear vacancy rate increased compared with midyear 2001. In St. Louis, the market ended 2002 with positive absorption. Commercial construction opportunities are mixed. Construction activity has been slow in northeast Arkansas. Contacts in Tennessee reported an increase in nonresidential work in November over the same month last year; however, they also indicated a bleak outlook for commercial construction. In central Kentucky, construction of hospitals, churches, and college facilities remains strong.

Banking and Finance
Total loans outstanding at a sample of small and midsized District banks were up 2.3 percent between early October and early December. This increase was driven by real estate loans, which were up 3.5 percent over the same period. Commercial and industrial loans have increased slightly over the period, growing 0.2 percent. Loans to individuals and to commercial banks have declined 1.4 percent and 0.5 percent respectively. At the same time, total deposits at these banks were up 5 percent.

Agriculture and Natural Resources
The unusually cold weather in past weeks had a significant effect on District energy use and prices. District diesel fuel and gasoline prices rose 6 cents and 11 cents per gallon, respectively, during the latter half of December. Contacts were concerned that spring fertilizer and fuel will be more costly. Natural gas prices, in general, rose about 33 percent between October and December. District coal production, although down 4 percent from last year, has increased slightly in recent weeks. District farmland values, on average, rose 3.8 percent, from $1,870 per acre in 2001 to $1,941 per acre in 2002. Increased demand for land for investment purposes and recreational use, as well as government subsidies contributed to the rise in prices.

Return to top

Ninth District--Minneapolis

Ninth District economic activity was subdued from mid-November through early January. Tourism, agriculture and commercial construction activities were down. Consumer spending and energy were flat. However, manufacturing, home building and mining grew. Over this period, labor markets tightened slightly, while overall wage and price increases were modest. Significant price increases were noted in employee benefits, natural gas, and gasoline.

Construction and Real Estate
Commercial construction was down slightly. The value of contracts awarded for new construction projects in Minnesota and the Dakotas was down 1 percent for the three-month period ending in November compared with last year. In the Minneapolis-St. Paul area, commercial real estate market reports suggested that speculative construction of office and industrial space has essentially stopped, while office vacancy rates continued to increase. In contrast, vacancy rates for retail space in the Minneapolis-St. Paul area are relatively low; an estimated 26 percent more space is under construction for 2003 compared with the amount of new space added in 2002, according to a commercial real estate expert. In Rochester, Minn., several permits were issued in November for new large commercial projects.

Home building was up from a year ago. Housing units authorized in District states were up 5 percent for the three-month period ending in November compared with a year ago. In Minneapolis-St. Paul, demand for multifamily buildings has spurred construction, according to a builders association representative. A realtor in Sioux Falls, S.D., noted high levels of refinancing activity and remodeling during 2002 compared with 2001, and he expects fewer families to move during 2003.

Consumer Spending and Tourism
Overall holiday sales were soft. A major Minneapolis-based department store and discount retailer reported that same-store sales were down below plan after Dec. 25, although December growth was far below the retailer's goal of a 3 percent to 5 percent increase over last year. A Minneapolis area mall manager reported that although traffic was solid, customers were buying less and therefore sales were down slightly from last year. In northeast Montana, holiday retail sales were about level with last year, while in the Dakotas sales were down at stores in rural communities, but some increases were noted at stores in larger cities, according to bank directors.

In contrast, a chamber of commerce official in northern Wisconsin reported that area big box and downtown retailers had solid sales during the holidays. In North Dakota, a mall reported just under 5 percent growth in holiday sales, with particularly strong sales in gift certificates and jewelry. A Minneapolis mall manager reported strong traffic and sales after an extended remodeling project.

Auto sales were generally slow. In Minnesota, auto sales were soft in December compared with a year ago, according to a representative of an auto dealers' association. After a period of slow November auto sales in South Dakota, sales picked up somewhat in the beginning of December, according to another auto-dealers' association representative.

Winter tourism got off to a very slow start due to the lack of snowfall across the District. Business was down substantially in the Upper Peninsula of Michigan and northern Wisconsin at establishments that rely on snowmobile traffic. In the Black Hills of South Dakota, downhill ski areas reported fair lift ticket sales, but snowmobiling was off 70 percent from last year. A Montana ski resort reported some slow lift ticket sales, but lodging reservations going forward are ahead of last year.

Manufacturing
Manufacturing activity was up slightly. A December survey of purchasing managers by Creighton University (Omaha, Neb.) indicated increased manufacturing activity in Minnesota and the Dakotas. A North Dakota heavy equipment parts manufacturer reported strong December sales at 140 percent of forecast. In Minnesota, a metal fabricator plans to open a plant, and a printed circuit board manufacturer expects to expand production. In Wisconsin, an ethanol plant also plans to grow. However, a furniture production facility in Minnesota will close, and a baked goods manufacturing plant will close in western Wisconsin.

Energy and Mining
Activity in the energy sector was level, while the mining sector was up slightly. Late December District oil and natural gas production and exploration levels were about even with mid-November. Meanwhile, most District iron ore mines are operating at capacity. A Montana mining official reported overall steady and optimistic mining activity, with an uncertain palladium and platinum production and profit outlook, given the purchase of the only U.S. producer by a Russian company.

Agriculture
The agricultural economy was down due to lack of moisture and lower hog and milk prices. The lack of snow cover across the District threatened the winter wheat crop and topsoil. In addition, lack of moisture worsened the drought in Montana and the western Dakotas. Meanwhile, December hog and milk futures prices were down 5 percent and 3 percent, respectively, from late November to late December.

Employment, Wages, and Prices
Labor markets tightened slightly. After 15 consecutive months of declining employment levels in District states, employment increased slightly during October and November compared with the previous year. Furthermore, a metal fabricator will open a plant in South Dakota in the spring and plans to employ up to 125 employees. A new automobile parts distribution center in northwestern Wisconsin will employ up to 80 workers.

However, some layoffs were reported. In southwest Minnesota a poultry plant recently announced its closing, affecting 162 jobs. A machine manufacturer shut down a plant in the Upper Peninsula that resulted in 90 layoffs. A tractor plant in North Dakota will lay off 30 workers early in 2003, after laying off 30 employees in October and November due to the slow farm economy.

Wage increases were moderate. District wages for manufacturing workers were up 1.7 percent for the three-month period ending in November compared with last year. In Minnesota, wages for construction workers were flat from a year ago, while wages for workers in retail and wholesale trade were up 2.3 percent for the three-month period ending in November compared with last year.

Overall price increases were modest, except for significant increases noted in employee benefits, natural gas, and gasoline. Bank directors reported that while overall prices are expected to remain relatively level in 2003, significant price increases are expected in employee benefits and natural gas. Health benefits for employees of businesses in the state of Wisconsin increased 15 percent in 2002. Recent gasoline prices in the Minneapolis-St. Paul area were up over 33 percent from a year ago.

Return to top

Tenth District--Kansas City

The Tenth District economy was very sluggish in December. Holiday retail sales were little changed from a year ago, energy activity failed to rise despite higher prices, and commercial real estate activity remained soft. Moreover, motor vehicle sales eased again and manufacturing activity weakened after showing signs of stabilizing in the fall. On the positive side, housing activity maintained a solid pace, and tourism was very strong at ski resorts in the Rocky Mountains. In the farm economy, many ranchers and farmers continued to suffer from drought conditions. Wage and price pressures remained largely subdued across the district, although some materials prices rose slightly.

Consumer Spending
Overall, holiday retail sales in the district were flat compared with the previous year. Discount stores and department stores that ran extensive promotions reported the best performance, while sales at most higher-end stores and other retailers were somewhat softer than a year ago. Sales of toys and electronics were brisk at most stores, but sales of big-ticket home items and most types of apparel were weaker than expected. In spite of the less-than-stellar holiday season, store managers generally maintained optimism about future sales. Due to cautious expansion of inventories in advance of the holidays, nearly all managers were also satisfied with current stock levels and planned few adjustments in coming months. Motor vehicle sales shrank somewhat further in December and were below year-ago levels across the district. Still, most auto dealers considered 2002 a fairly solid year. Dealers expect little improvement in sales in coming months, however, and many plan to trim inventories. In the tourism industry, plentiful snow helped Rocky Mountain ski resort operators enjoy one of their best holiday seasons ever, resulting in very strong revenues for local shops, restaurants, and other establishments.

Manufacturing
District manufacturing activity weakened somewhat in December after showing signs of stabilizing in late fall. Production, new orders, and capital spending all fell back below year-ago levels after firming in October and November. The reported declines in activity were also widespread across manufacturing industries. One positive note came from aircraft manufacturers in the district, who reported that new defense orders were helping to offset some of the slowdown in that industry. Overall, plant managers were slightly less optimistic about future factory activity than in previous surveys, but a majority continued to anticipate some increase in production and shipments in the spring. Capital spending plans remained rather modest, however, with most firms expecting little change from 2002 expenditure levels.

Real Estate and Construction
Residential real estate activity in the district remained solid in December, while commercial real estate activity was still weak. Single-family housing starts continued at high levels except in some areas of Colorado, with rapid construction of entry-level homes offsetting some slowing in higher-end building. Construction of multifamily units slowed somewhat from previous surveys, due largely to the continued strong demand for entry-level houses. Most builders expect home construction to remain solid through the spring. In contrast to housing starts, reports on home sales were mixed. Realtors in several cities reported that home sales eased in December, resulting in some buildup in inventories of unsold homes. Realtors in Denver, Colorado Springs, and Tulsa also noted some small declines in average selling prices from previous months. However, realtors in some other cities noted a pickup in home sales during the month and were optimistic about the future. Mortgage demand remained strong in December, but lenders expect some slowing in coming months as refinancing activity wears down. Several lenders also expressed concern about the declining credit quality of borrowers. Commercial real estate activity was still weak in most District cities. Construction, absorption, and prices of office space were largely flat or lower compared with the previous survey. Vacancy rates edged up further in Denver and showed no improvement in other cities. Most commercial realtors expect continued weakness in District office markets for the foreseeable future.

Banking
Bankers report that loans edged down and deposits held steady since the last survey, reducing loan to deposit ratios slightly. Demand increased slightly for home mortgage loans and was unchanged for home equity loans. However, demand for other loan categories edged down, with most bankers attributing the declines to the sluggish economy. On the deposit side, a small increase in demand deposits was offset by slight declines in large CDs and small time deposits. All respondent banks left their prime lending rates unchanged since the last survey, and most banks also held their consumer lending rates steady. A few respondents tightened their lending standards, citing concerns about the economy.

Energy
District energy activity was flat in December, as recent increases in energy prices have yet to spur more drilling. The count of active oil and gas drilling rigs in the region was unchanged from November and down slightly from the summer months. Both oil and natural gas prices reached two-year highs in December, but many District producers remain cautious about expanding activity due to uncertainty about future prices. Some natural gas producers also reported difficulty securing financing for exploration. In addition, limited pipeline capacity from Rocky Mountain gas fields continues to constrain prices and activity to some degree in that region.

Agriculture
In the District's agricultural sector, much of the winter wheat area remained extremely dry. Some areas received beneficial snowfall, but subsoil moisture was still well below normal. Despite the dry conditions, forage supplies appeared to be adequate for the winter months. Feedstuffs from abandoned crop fields and emergency grazing of Conservation Reserve Program acres extended feed supplies and allowed cattle ranchers to maintain herd numbers. However, if drought conditions persist and erode feed supplies, some ranchers could face additional herd liquidations. Given preliminary reviews of their farm loan portfolios, District bankers do not expect new repayment problems to surface. Some bankers reported a decline in farm loan demand for real estate and machinery.

Wages and Prices
Wage and price pressures remained generally subdued across the District in December, although some materials prices rose slightly. Labor markets were still very slack, with worker shortages reported only in the health-care field and for some building trades. The pace of layoff announcements eased somewhat from the previous survey but was higher than in the early fall. There was little evidence of wage pressures, with most firms offering only cost-of-living increases for 2003. Retail prices fell slightly due to holiday discounting but are expected to hold steady through the spring. Some builders again reported increases in plywood prices, and several other building materials prices are expected to rise slightly in coming months as well. Manufacturers reported that steel price increases have subsided recently due to weakened demand. Some other manufacturing material prices have risen lately, however, and are expected to increase further. At the same time, manufacturers' finished goods prices continue to fall, putting more pressure on their profits.

Return to top

Eleventh District--Dallas

Overall Eleventh District economic activity remained anemic from mid-November through early January. Demand was weak for most manufacturing and service firms. Construction activity continued to soften. Retailers were disappointed by holiday sales. Although there was a slight pickup in energy activity, the gains were substantially less than would have been expected given the sharp increases in energy prices. The financial services industry reported little change in activity, including no significant changes in delinquencies or charge-offs. Agricultural conditions also were largely unchanged. Respondents say that the uncertainty about war with Iraq continues to restrain business investment.

Prices
Price reports were mixed. Prices were up sharply for crude oil, natural gas, heating oil, gasoline, and residual fuel oil. Cold weather in the Northeast and Midwest spurred demand for energy while geopolitical forces reduced international supply. OPEC cut production ahead of the normal seasonal reductions, and a general strike in Venezuela halted all exports, including oil. In addition, contacts say the "war premium" has returned to energy prices. Natural gas inventories, which were at record levels in early November, are now 17 percent below the levels of last year and 5 percent below the five-year average. Crude oil inventories are 11 percent below the level of a year ago and declining.

Outside energy, weak demand, and stiff competition is preventing higher energy costs from being passed along to consumers. Selling prices were unchanged for most manufactured products. The sharp increase in natural gas and oil prices has primarily come out of profit margins for petrochemicals, where product prices are stable or declining. Downstream plastic and synthetic rubber prices, all rising sharply throughout the first half of 2002, showed no significant changes in price in recent weeks. Prices for paper products have fallen since the last Beige Book, although this was expected to be partly offset by a decline in the price of some inputs, such as wood derivatives. Inventories are up for some construction-related products, such as cement and glass. While there were scattered reports of price increases in the service sector, airlines and retailers reported stiff competition and price declines. Retailers said that inventories are in good shape.

Manufacturing
Manufacturing activity continued to be weak in late November, December, and the first week of January. There was no improvement in energy-related manufacturing activity, while construction-related activity continued to soften. The high-tech industry shows signs of improvement, but contacts say the uncertainty surrounding war with Iraq is delaying business investment.

Demand was unchanged for food products and primary metals. Apparel producers said demand was unchanged or a little slower than expected. Demand for paper products was better than expected, according to contacts, who said that while there has not been much change over the past month, sales have been higher than a year ago.

Demand for construction-related manufactured products accelerated its decline over the past six weeks. Continued weakness in commercial construction along with reduced residential construction was blamed for the slowdown. Sales of lumber, wood products, stone, brick, and glass were below year-ago levels. Sales of fabricated metals were slightly above last year's levels, however, buoyed by construction of schools, hotels, and churches.

Contacts in the high-tech manufacturing sector report that conditions remained flat to slightly improving. Business demand was weak, but consumer demand is increasing slightly. Inventories are reported to be very lean for producers and retailers.

U.S. refinery utilization was up nationwide, but activity was down slightly along the Gulf Coast. Supplies to several Gulf Coast refineries are being impaired by the loss of crude oil from Venezuela, which forced a reduction in operations at some refineries. Other refiners have been able to buy enough crude oil on the spot market to maintain operations. There is no indication of improvement in demand for petrochemicals. Overcapacity remains a significant problem for some products, such as ethylene.

Services
Service sector activity remained weak. Accounting, legal, and temporary firms said demand was still slow. While there were some very slight signs of improvement over the past three months, contacts say global uncertainties lead them to be cautious.

Demand for transportation services remained weak, although some firms reported better than expected holiday traffic. Airlines continue to develop war contingency plans to analyze potential implications of war with Iraq, as well as risks resulting from recent bankruptcy filings by several major players. Cutting costs, improving efficiency, and fine-tuning existing capacity remain top priorities for airlines to return to profitability. After the bankruptcy filings, employees in the industry find themselves under intense pressure to provide wage concessions and boost productivity.

Retail Sales
Retailers said holiday sales were generally disappointing, with particularly poor sales of apparel and computers. Most contacts are less optimistic about the outlook for the first half of 2003, because of the war "wildcard" and because higher energy costs are expected to reduce consumer's disposable income. Auto sales remained weak, and contacts believe future growth prospects are poor. New car sales are expected to end the year roughly 8 percent below a year ago. Big incentives and zero-percent financing continue but are not having the same effect as earlier. Dealers say that some consumers seem to be anticipating price declines in the months ahead and are waiting instead of buying today.

Financial Services
Deposit activity remained strong, particularly at consumer-oriented institutions who have a large customer base. Contacts reported little change in loan activity and, as a result, loan-to-deposit ratios have shrunk for much of this year. Consumer lending continued to be the weakest category and account for a major portion of delinquencies and charge-offs. Real estate lending is still the strongest category, but auto lending slowed during the second half of the year. Commercial and industrial lending is flat to down for most contacts. Smaller banks have continued to outperform larger banks that have exposure to national financial market turmoil.

Construction and Real Estate
Activity continued to be at low levels in late November, December, and early January. Demand was still weak for home prices above $250,000. Lower priced homes sold briskly, according to contacts, who said the market was being stimulated by steep concessions from builders and low interest rates. Office markets were unchanged, and market contacts expect it will be at least two years before it improves. The industrial market also continues to be weak, although there were reports of pockets of strength. The multifamily segment in Austin and Dallas continues to suffer from lackluster leasing demand.

Energy
Energy activity increased only slightly despite sharply rising prices for both oil and natural gas. Producers increased short-term oil drilling and increased gas-directed drilling to take advantage of higher prices. There was little change in activity in the Gulf of Mexico, a more expensive and risky investment. Respondents say that improvement in domestic activity is now probably postponed to the second quarter of 2003.

Agriculture
Conditions remained largely unchanged since the last Beige Book. Moisture levels are generally favorable, although excess moisture impaired the harvest in some areas. Producers continue to rely on government payments to offset weak production revenue.

Return to top

Twelfth District--San Francisco

Twelfth District contacts reported sluggish growth in economic activity during late November and December, with little change in most industries from trends reported in the previous survey. Regarding prices, reports indicated widespread heavy discounting among retailers and little upward pressure on prices for most other sectors. Increases in wages and salaries were modest, and employers passed on some of the increases in health-care costs to workers. Aside from strength in selected products, holiday spending by consumers was flat to slightly down relative to last year. Conditions in District manufacturing were mixed, with improvements in the sales of selected semiconductor products and expansion in defense-related industries. In contrast, demand in the commercial aircraft and telecommunications markets remained weak. District manufacturers noted continued excess capacity and muted long-term investment activity and research and development (R&D) spending. The weakening of the dollar boosted exports of District agricultural products. Commercial real estate remained stagnant across District markets, while home sales were at elevated levels, although the pace of growth abated slightly. Bank contacts reported continued growth in deposits but continued weak demand for business loans in most areas.

Prices and Wages
Respondents in the District reported that in recent weeks prices exhibited very little upward movement. One exception was energy; contacts noted high levels of capacity utilization for producers of natural gas and electricity services, suggesting possible upward pressure on energy prices in the near term. Among retail trade sectors, businesses perceived little pricing power, which led to deep discounting during the holiday season.

Labor markets for most types of jobs appear tilted in favor of employers according to survey respondents, and layoffs continued in selected retail, services, and high-tech industries. District firms passed on some of the increases in health-care costs to workers by requiring them to pay a greater share of premiums, reducing benefits, and/or slowing wage growth. The combination of the increase in costs of employer-provided health benefits, the weak labor market, and limited pricing power in most industries restrained growth in employee wages and salaries during late November and December, according to District contacts.

Retail Trade and Services
District contacts reported that, with the exception of Hawaii, overall holiday retail revenues were flat or slightly down relative to last year. This lackluster performance was well below expectations. Heavy discounting appeared to be pervasive and substantially greater than during the same period last year. Discount stores reportedly performed better than department stores and establishments specializing in certain high-end products. Consumer durables, especially electronics such as DVDs and cellular phones, sold well in recent weeks, particularly those at the lower end of the price spectrum. Respondents noted that Internet sales, though still miniscule relative to in-store sales, were up considerably from a year ago.

The services sector continued to face weak demand in late November and December. Contacts in advertising and related businesses noted that demand for their services was soft in recent weeks. Conditions in District travel and tourism sectors generally were mixed during the survey period; international visitor counts remained weak, while domestic tourism continued to improve. Contacts reported record normal hotel occupancy rates in Hawaii in recent weeks, and time-shares continued to provide a stable source of tourism to the state. Moreover, early season ski bookings at District skiing destinations were up from previous years. In some other areas, though, hotels and other lodging establishments continued to struggle with low occupancy rates.

Manufacturing
District manufacturing conditions remained mixed in recent weeks. Sales of semiconductors have continued to improve over a year ago, notably for wireless technologies. Demand conditions remained relatively stable in biotech industries. Defense-related manufacturing, particularly in Southern California, strengthened due to heavy spending by the federal government related to homeland security and possible military action in Iraq. In contrast, the tepid demand for commercial aircraft and telecommunications products has not improved since the last survey period, and District producers of these products continued to grapple with considerable excess capacity.

Excess capacity also remained an issue for most other District manufacturers. Contacts noted that capacity utilization generally remained below targeted levels, and it would likely take six months to a year for manufacturers to reach targeted levels at the current pace of expansion. The excess capacity in District manufacturing establishments is expected to be a drag on capital expenditures in the months ahead. Respondents noted that planned R&D outlays by many manufacturing firms also have been curtailed, both in absolute terms and relative to capital expenditures. An exception to the general rule of excess capacity and slow growth in R&D was the biotech industry, with firms reportedly nearing targeted levels of capacity utilization and experiencing continued expansion in R&D budgets in recent weeks.

Agriculture and Resource-related Industries
Overall conditions for District agricultural and resource-related businesses improved slightly during the survey period. District contacts noted that the weakening of the dollar boosted exports and allowed higher prices in both domestic and foreign markets for agricultural and resource-based products. Respondents reported high capacity utilization in natural gas and electricity services, which could put upward pressure on prices in the near term as well as lead to increased capital expenditures.

Real Estate and Construction
Conditions in District real estate changed little in the survey period. Commercial real estate remained stagnant across District markets. Contacts noted that commercial real estate likely will experience very little new construction in 2003, as high office vacancy rates in markets such as the San Francisco Bay Area likely will restrain new construction for as long as two years. On the other hand, contacts noted that office rental prices in San Francisco appeared to have hit bottom in recent weeks, and that downtown Los Angeles ended 2002 with office vacancies on the decline.

Home sales remained at elevated levels, although the pace of growth in sales slipped a bit further in late November and December. Prices for both single family homes and condominiums continued to increase in many District markets.

Financial Institutions
District contacts reported continued growth in deposits, while nonresidential loan demand weakened further in some areas in the survey period. Banks reported high levels of liquidity but weak demand for business loans.

Return to top

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