January 19, 2005

The Beige Book

Summary of Commentary on Current Economic Conditions by Federal Reserve District

Summary

Prepared at the Federal Reserve Bank of Richmond and based on information collected before January 10, 2005. This document summarizes comments received from businesses and other contacts outside the Federal Reserve and is not a commentary on the views of Federal Reserve officials.

Reports from the twelve Federal Reserve districts indicated that economic activity continued to expand from late November through early January. Eleven districts characterized activity as expanding with Atlanta, New York, and Richmond noting that the pace of activity had quickened since their last reports. The Cleveland District was less upbeat, characterizing economic activity in that district as mixed.

Consumer spending was generally higher since the last Beige Book and a number of districts reported that retail sales during the holidays were above year-ago levels. While the pace of spending was sluggish in a number of districts at the beginning of the period, it picked up appreciably by late December. Adding to the strength in household spending was an increase in tourism in several districts. Most districts reported that manufacturing activity firmed and many districts said that businesses planned to increase capital spending in 2005. Although several reports noted some slowing in residential real estate and construction activity, real estate markets remained generally strong. In the financial sector, lending activity was mixed, as modestly higher commercial and industrial lending was tempered by slower residential mortgage lending. Several districts noted that agricultural conditions were favorable and that activity in the energy sector remained strong. Labor markets firmed in a number of districts, but wage pressures generally remained modest. Several districts reported higher prices for building materials and manufacturing inputs, but most reported steady or only slightly higher overall price levels.

Consumer Spending and Tourism

Consumer spending increased in most districts since the last Beige Book report, with only Cleveland, Dallas, and New York reporting that sales were mixed. Boston, Chicago, Dallas, New York, Richmond, and San Francisco said that retail sales were slow in early December but picked up the pace from Christmas through the end of the year. Sales of luxury goods were strong in the Kansas City, Philadelphia, and San Francisco districts, while retailers in the Atlanta, Chicago, and Kansas City districts reported that electronics and jewelry sold well during the holiday season. Boston, Richmond, and San Francisco reported higher sales of building supplies, and Boston, Chicago, and St. Louis noted strong sales of apparel. Gift cards sold briskly according to the Chicago, Kansas City, Minneapolis, and New York reports. Post-holiday retail inventories were at satisfactory levels in the Kansas City, New York, Philadelphia, and San Francisco districts.

Automobile sales were mixed. Atlanta, Chicago, Cleveland, and Kansas City noted higher sales, but St. Louis and Dallas said new car sales slowed. Atlanta, Philadelphia, and San Francisco noted that sales of foreign cars outperformed domestic makes. Dealers in the Chicago, Dallas, and Philadelphia districts reported that automobile dealers' inventories remained above desired levels.

Tourist activity strengthened in several districts. Boston said that increased business travel, corporate spending, citywide conventions and increased international travel boosted hotel occupancy rates. Occupancy rates were also up in the San Francisco district, and the number of Japanese visitors to Hawaii has returned to pre-September 11 levels. New York noted that tourist activity was higher both upstate and in New York City where Broadway theaters set a box-office record during the last week of the year. In addition, the Atlanta report indicated that tourism was strong and that central Florida theme parks were filled to capacity. Kansas City indicated that some ski resorts in the district reported near-record levels of visitors. Richmond reported that because of unseasonably mild weather, hotels were booked to capacity in coastal areas and that some were turning tourists away during the week after Christmas.

Services

The Dallas, New York, Philadelphia, San Francisco, and St. Louis districts reported steady to stronger demand at services firms since the last Beige Book report. Atlanta, San Francisco, and St. Louis noted stronger demand for transportation services, with some seaports in the Atlanta district posting double-digit gains in both inbound and outbound shipping. Air passenger traffic was higher at airports in the Chicago, Dallas, Kansas City, and St. Louis districts while air freight volume increased in the Atlanta district. New York's report also noted that the securities industry ended 2004 on a strong note.

Manufacturing

Manufacturing activity strengthened since the last Beige Book report. Nine of the 12 districts indicated that factory output rose, while Chicago, Cleveland, and Richmond noted that production was steady. Boston, Philadelphia, and San Francisco indicated that demand for transportation equipment strengthened measurably. Production of electrical machinery increased in the Philadelphia district, and Chicago reported strong output of heavy equipment. Atlanta, Dallas, and San Francisco reported that production of building materials picked up, while Chicago and San Francisco indicated that orders for machine tools increased in their districts. San Francisco reported that semiconductor orders and sales were generally solid.

But some manufacturing sectors weakened. Richmond reported that textiles and apparel shipments continued to decline. Atlanta reported layoffs at a computer circuit board plant, and Dallas noted slowing demand in consumer communications equipment. Philadelphia indicated that demand softened for lumber and wood products, paper products, and plastics, and Cleveland reported that sales at automobile industry suppliers slowed at year-end. St. Louis said that firms in the fabricated metal product, wood product, chemical, and apparel industries announced plant closings and layoffs.

Looking ahead, manufacturers expected conditions to remain positive in coming months. Most districts reported that manufacturers intend to increase their capital spending in 2005. Firms in the Chicago district upped their planned capital expenditures for next year; most have already begun to place orders to accomplish those spending goals. Minneapolis indicated that expectations of higher sales by businesses led to plans to increase capital spending in 2005. Kansas City noted greater capital spending in 2005 to replace outdated equipment. Richmond reported that manufacturers planned to increase capital spending despite their skepticism about the sustainability of the U.S. economic recovery.

Construction and Real Estate

Residential real estate activity generally remained strong. Atlanta, Boston, New York, Richmond, and San Francisco said that housing markets in their districts continued to show strength in the fourth quarter of 2004, and Dallas and St. Louis reported some improvement since the last Beige Book. Chicago reported mixed housing activity, possibly because of a seasonal slowdown in December, but noted a slight pickup in sales during the first week of January; real estate activity was also mixed in the Minneapolis district. The Kansas City District reported flat to slightly higher home sales compared with a year earlier. New York reported that prices for upper-end New Jersey properties leveled off, or pulled back, but that prices for Manhattan co-ops and condos continued to rise. Richmond said home prices continued to rise in most areas of that district.

Commercial real estate conditions strengthened in most districts in December and early January. Real estate agents in the Dallas, New York, Richmond, San Francisco, and St. Louis districts reported that leasing activity increased--particularly for office space. Office leasing was especially brisk in Washington, D.C., and New York City, two of the nation's strongest commercial markets. Contacts in New York said the recent uptick in activity sent the Class A office vacancy rate to a two-and-a-half-year low and may be a signal of increased hiring in that area. In other districts, vacancies were mixed--rates dipped in San Francisco, St. Louis, and most of the Kansas City District, but were generally unchanged in other areas. Adding to the positive tone, commercial construction activity was higher since the last Beige Book report--contacts in Atlanta, Chicago, Minnesota, Richmond, and St. Louis reported new industrial or office construction activity, while retail construction maintained a generally steady pace.

Banking and Finance

Lending activity remained generally mixed as slower residential mortgage lending offset somewhat higher commercial and industrial lending in many districts. Commercial lending was modestly higher in the Atlanta, Chicago, and San Francisco districts while commercial and industrial lending was stronger in the Kansas City, Philadelphia, and St. Louis districts. Residential mortgage lending, however, declined in the Chicago, Dallas, and New York districts.

Several districts reported that credit conditions were steady, though Dallas added that competition between banks in that district could threaten credit quality in the months ahead. In addition, Chicago and San Francisco reported that banks' profit margins on loans were thin.

Agriculture and Natural Resources

Several districts noted that crop and livestock conditions were generally favorable, despite widely varying weather conditions. Richmond indicated that unseasonably warm weather in early December accelerated the development of winter grains and extended the grazing period for livestock. But very cold temperatures and snowfall in late December led to supplemental feeding of livestock. A major snow storm affected part of the St. Louis District in late December, leaving fields and pastures muddy. Despite the excess soil moisture, St. Louis said the winter wheat crop was in mostly fair to good condition. Minneapolis noted that Montana's 2005 winter wheat crop was good to excellent despite little snow cover to protect against freeze or wind damage. Kansas City added that some producers in the western part of its district remained concerned that dry pastures could deteriorate further.

Agricultural prices were generally higher. The Chicago district reported that net farm income jumped last year as a result of profitable livestock operations and record corn and soybean harvests, much of which was forward-contracted at unusually high prices. In addition, Minneapolis reported milk prices were higher.

Activity in the energy industry remained strong according to reports from the Dallas, Kansas City, Minneapolis, and San Francisco districts. Minneapolis indicated increased mining activity, noting that the delivery of some mining machinery required two-year waits. Kansas City reported that oil and gas drilling rig counts remained well above year-ago levels, and noted constraints on drilling due to labor and equipment shortages. Dallas added that the level of land drilling was mostly unchanged but that offshore activity had picked up.

Labor Markets

Districts generally reported firmer labor markets in late 2004. Contacts in Dallas, Kansas City, Minneapolis, New York, and Richmond reported improvement on the job front, while respondents in Boston, Chicago, and San Francisco saw little change in hiring activity.

Manufacturing employment rose in Kansas City, New York, Richmond and St. Louis, while factory owners in Philadelphia anticipated adding workers in coming months. Planned factory hiring in Cleveland was mixed by product type--producers of nondurable goods predicted little change in future hiring, but makers of durable goods anticipated adding to their payrolls in the months ahead. Services sector respondents in Dallas, Richmond, and St. Louis reported broad-based strengthening in services sector employment, and contacts in New York and Philadelphia noted a particularly strong pickup in securities industry hiring.

Information on employment staffing services firms was mostly positive, but varied by district. Contacts in Cleveland, New York, Philadelphia, and St. Louis reported a moderate to brisk rise in demand, but Richmond noted generally flat activity and Dallas reported a softening in demand for temporary workers. Chicago also experienced a modest decline, but attributed it to a normal seasonal lull.

The reports from Kansas City, Minneapolis, and San Francisco indicated that wage increases generally continued to be modest. However, Cleveland noted that in response to the strong pickup in shipping demand, trucking firms have been attempting to expand their workforce by raising their wage rates and offering nonpecuniary incentives. Kansas City also noted higher wages for skilled factory workers in short supply, while Richmond noted that wage increases picked up in the services sector.

Prices

Inflationary pressures remained largely in check in December and early January. While many manufacturers and builders continued to report small increases in input costs, price increases for final goods and services were generally modest.

In manufacturing, input prices rose modestly in most districts, but Boston and Minneapolis reported that some input prices rose sharply. Manufacturers of nondurable goods in the Cleveland district noted that prices for raw materials continued to rise; while prices for durable goods inputs also rose. Prices charged by manufacturers increased modestly in Kansas City, New York, and Richmond, and remained in check in Atlanta and Chicago. Increases in the costs of building materials were mixed by district. Modest to sharp price hikes were widely reported in Atlanta, Kansas City, and Minneapolis, but material prices were flat in Cleveland and New York, and eased somewhat in San Francisco.

Overall, price inflation remained relatively steady in recent weeks. Reports from Atlanta, Boston, Chicago, Kansas City, New York, Richmond, and San Francisco reported that price increases remained largely in check. Contacts in Dallas noted that many firms were unable to pass rising costs along to the customer due to stiff competition, and Chicago noted that competition in the retail sector is expected to limit price increases.

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First District--Boston

Business contacts in the First District continue to be fairly upbeat. Retailers enjoyed higher sales in the year-end quarter than a year earlier, for the most part, and tourism strengthened measurably. Manufacturers in many sectors report growing fourth quarter revenues year-over-year. Residential real estate markets remain strong. Insurers say demand is increasing at a slow to moderate pace. Across all sectors, contacts are positive about prospects for continued expansion in 2005.

Retail and Tourism

Overall, retail respondents in the First District report sales are ahead of last year in the quarter ending in December; same-store year-over-year sales ranged from flat to up 3 percent. Holiday shopping was generally slow until two weeks before Christmas. Clothing, shoes, flat panel televisions, and MP3 players were said to be strong sellers, while renovation and lumber materials sales were also up.

Contacts report mostly steady vendor and selling prices, with the exception of decreases in flat-panel television prices and increases for home appliances and lumber-based products. Inventory levels are mixed, and employment levels are said to be mostly steady, as seasonal hiring was minimal in November and December. About half of the respondents note increased capital spending plans in 2005, while the remainder report no changes or decreases.

According to contacts, travel and tourism in the Boston area continued to improve in the fourth quarter, ending above year-ago levels. Increased business travel, corporate spending, and city-wide conventions all contributed to the pick-up. In addition, international travel reportedly increased 11 percent. As a result of this growth in activity, hotel occupancy and rates are up, and the revenue per available room increased by double digits. In December, client and corporate holiday parties boosted revenues for restaurants and special event businesses, exceeding last year's levels.

Most of the contacted retailers anticipate further improvements in 2005. Though contacts expect only moderate gains, unlike earlier reports, they expressed little concern about external factors, such as fuel prices, consumer confidence, and the war in Iraq.

Manufacturing and Related Services

Most First District contacts in manufacturing and related services report that sales and orders in the fourth quarter of 2004 were above year-earlier levels. The number of firms indicating that their revenue growth is accelerating is about the same as the number reporting deceleration. Contacts generally express the view that the economy will provide moderate positive support for their business in 2005.

Demand for ground transportation equipment is surging, and one large company notes that its trucking firm customers are having a hard time finding drivers. Biopharmaceutical businesses say that industry revenues continue to grow at a double-digit rate, but their own sales tend to be bumpy because they are driven by patterns for individual drugs. On the other hand, manufacturers of some consumer products report that demand has been muted.

A number of manufacturers mention that they are paying substantially more for metals, petroleum-based chemicals, and energy than they did one year earlier. In addition, some express heightened concern about the possibility of further cost hikes for transportation and distribution, as well as foreign inputs. Respondents tend to agree that cost increases from 2004 are likely to result in further attempts to raise prices in 2005, but they have differing views on customer receptivity and they are giving considerable thought to appropriate strategies. For example, one manufacturer met unexpected resistance to its attempt to raise selling prices on one category of products in late 2004 but is nonetheless considering raising prices for another category in 2005. Another is intent on trying to pass through cost increases "before the window closes." However, a couple of other firms have decided to hold off on increasing prices until their newer technology products gain a foothold in the marketplace. Prices for innovative drugs are on the rise, reflecting producer market power.

Most manufacturers are making only minor adjustments in their U.S. headcounts. Their continued drive for cost containment is putting downward pressure on employment, but some need new employees to generate added sales. Pay increases for 2005 are expected to be in the range of 2.5 percent to 4 percent, but firms are more likely to express concern about escalation in non-wage costs such as medical insurance and workers' compensation insurance. Most respondents intend to keep capital spending roughly unchanged from the amounts spent in 2004.

Residential Real Estate

Despite the usual seasonal slowdown, residential real estate markets throughout New England remain strong. Contacts report high levels of activity in most parts of the region, diminished somewhat by lack of inventory. Shortages of lower-end homes are especially noticeable. Indeed, houses in lower price ranges continue to sell quickly, while those with higher prices stay on the market longer than in the past. However, the longer time on the market is not substantial enough to cause price declines and the overall level of inventory has not changed markedly, according to most contacts.

In most areas, the number of sales in the last quarter of 2004 was similar to the last quarter of 2003, while sale prices increased. In Massachusetts, the number of sales in November was record-high, especially for condominiums, with November sales 27 percent higher than a year earlier. At the same time, the median sale price increased by double digits compared to November 2003. Vermont recorded similar price gains, while contacts in other states cite more modest price increases. Most contacts anticipate that the markets will remain stable in the next few months as long as interest rates stay low.

Insurance

Responding insurance companies in New England report slow-to-moderate demand growth in the fourth quarter of 2004. Sales of property and casualty insurance were healthy, especially in foreign markets, although the rate of growth may be slowing. Disability sales were flat in the fourth quarter, but claims continue their downward trend. Demand for individual life insurance continues to grow at a fair pace. Most contacts report intense price competition, resulting in slower rates of price growth or decreases in some cases. Employment and capital spending strategies remain conservative, reflecting modest rates of demand growth and limited needs to increase capacity. Respondents are generally optimistic, expecting Q1 2005 to be similar to 2004; at the same time, they remain somewhat concerned about a handful of issues related to price competition, terrorism, and interest rates.

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Second District--New York

The Second District's economy has clearly gained further momentum since the last report, and the labor market has taken on a firmer tone. While cost pressures persist, prices of final goods and services generally remain stable. Manufacturers continue to report fairly widespread improvement in business conditions, as well as a pickup in hours worked. Reports from the retail sector, though mixed, are generally more favorable than in the last report, with holiday-season sales roughly in line with expectations.

Residential real-estate markets showed continued strength in the fourth quarter, while office markets were steady to stronger. Tourism is characterized as increasingly robust in both New York City and upstate New York. The securities industry reports an upsurge in business activity, as well as a pickup in hiring, in the fourth quarter. Finally, bankers report a normal seasonal pullback in household loan demand, unchanged credit standards, and lower delinquency rates on commercial loans.

Consumer Spending

Holiday-season sales were mixed but, on balance, close to plan. Chain stores showed mixed results for the region in December: some indicate that sales were up 3 percent to 4 percent, which was moderately ahead of plan, but a number report that sales fell short of plan, declining by 1 percent to 3 percent. Similarly, a survey of smaller retailers across New York State indicates wide variation in sales results but decent sales overall. Both groups of retailers report that sales were weaker in the first half of the month but strengthened in the week before Christmas and continued strong through early January. Retailers generally attribute the late surge to discounting, as well as increased popularity of gift cards. Inventories were generally said to be at satisfactory levels. Virtually all retail chains indicate that prices were little changed from a year earlier, though a few contacts anticipate some pickup in costs and selling prices for apparel products in 2005 due to the recent expiration of import quotas.

Consumer confidence improved sharply in December, based on two separate surveys. Siena College's survey of New York State residents shows confidence jumping to a five-month high, led by a sharp gain in the New York City area. Similarly, The Conference Board's survey of Middle Atlantic state (NY, NJ, PA) residents shows confidence rebounding to a three-month high in December, led by a surge in the public's assessment of current conditions, which reached its highest level since September 2001.

Construction and Real Estate

Housing markets continued to show strength in the fourth quarter. New Jersey homebuilders report that the housing market remains steady and strong, though there are scattered reports that prices at the high end of the market leveled off or pulled back in late 2004. Prices of construction materials were generally steady in recent months, after significant escalation in 2003 and the first half of 2004. Similarly, New York State Realtors report persistent strength in the market for existing homes in late 2004, with transactions volume up about 5 percent from a year earlier and average prices up 15-20 percent. In Manhattan, a major residential broker indicates that selling prices for co-ops and condos, on average, were up 5-10 percent from a year ago, while a leading appraisal firm reports gains of more than 10 percent; both contacts note a dwindling supply of apartments on the market in recent months.

Commercial real estate markets were steady to stronger at year-end. Manhattan's Class A office vacancy rate fell to a 2½-year low of 9.6 percent, down from 10.3 percent in November. Midtown's market showed particular strength, with available space (both direct and sublease) continuing to shrink, and asking rents 10 percent higher than a year earlier. Downtown's vacancy rate fell by more than a point in December, but asking rents have been little changed over the last year. An industry contact notes that the recent pickup in both the Midtown and Downtown markets mainly reflects brisk leasing activity from the financial sector and may signal a pickup in hiring in the securities industry. Suburban markets around New York City showed little change: vacancy rates edged down in northern and central New Jersey and Fairfield County but edged up in Westchester County.

Other Business Activity

Manufacturers continue to report improving business conditions and ongoing price pressures. Preliminary results from our January survey of New York State manufacturers indicate continued widespread improvement in business conditions, along with a pickup in hiring and hours worked, and some acceleration in selling prices. Similarly, Buffalo-area purchasing managers indicate improved business conditions in December; however, purchasing managers in the New York City area indicate some moderation in manufacturing-sector activity in December, but continued strength in non-manufacturing sectors.

The securities industry ended 2004 on a strong note, according to an industry contact. Investor sentiment improved and activity picked up in virtually all business segments starting in late October and this trend gained momentum through December. The industry anticipates increased hiring in 2005 and stronger compensation growth than previously projected. More broadly, a major New York City employment agency, specializing in mid-level office jobs, reports that business was unusually brisk in both December and the first week of January, and that financial firms, in particular, have picked up their pace of hiring. Moreover, on the supply side, a growing share of job-seekers is reported to be looking to change jobs.

Tourism also ended 2004 on a strong note: Broadway theaters report a pickup in activity in December; though attendance and revenues for the month were slightly below the lofty levels of a year earlier, the last week of the year set a box-office record. Manhattan hotels report strong business in December: occupancy rates were up 2 percentage points from a year earlier, while room rates were up roughly 15 percent; also, bookings for January are said to be relatively strong. Hotel occupancy rates in the Buffalo and Rochester areas were also up noticeably from comparable 2003 levels, and Buffalo's airport notes robust growth in passenger traffic in November and December.

Financial Developments

Small to medium-sized banks in the Second District report a typical seasonal pullback in demand for consumer and home mortgage loans, while demand for commercial credit held steady. Demand for residential mortgages continued to slip, though declines were less widespread than they have been in six months. Bankers again report little or no change in their credit standards. Interest rates rose across all loan categories, particularly in commercial and industrial loans and commercial real estate. Deposit rates increased according to a majority of respondents, with only 6 percent of bankers reporting lower rates. Bankers report lower delinquency rates for both commercial real estate loans and commercial and industrial loans, while delinquency rates on both consumer and home mortgage loans were little changed.

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Third District--Philadelphia

Business activity in the Third District expanded in December. Manufacturers reported increases in orders and shipments during the month. Retail sales of general merchandise during the holiday shopping period were higher than last year, with modest gains for most stores and greater increases among luxury goods retailers. Auto sales were roughly steady during December. Banks reported that overall lending continued on an upward trend in December. Service companies generally reported a steady to slightly stronger pace of growth at year end compared with the fall.

Contacts in the Third District business community expect economic activity in the region to continue on an upward trend through the winter, and some contacts anticipate a slight quickening in the growth rate as the year progresses. Manufacturers expect increases in shipments and orders during the next six months. Retailers expect modest growth in sales during the year, but auto dealers expect sales to weaken. Bankers believe overall lending will continue to rise, although they do not anticipate much growth in residential mortgage loan volume. Service companies expect some pickup in the pace of growth for their businesses.

Manufacturing

Manufacturing activity in the Third District increased in December. Around four out of ten of the manufacturing firms surveyed during the month posted higher shipments and orders compared with the previous month, and less than two in ten reported decreases. Order backlogs at area plants edged up slightly from November to December although delivery times were unchanged. Business conditions varied among the major manufacturing sectors in the region. Growing demand was generally reported by makers of food products, apparel, electrical machinery, and transportation equipment. Some slowing in demand was reported by makers of lumber and wood products, paper products, and plastics.

The region's manufacturers generally expect further gains in business activity. Just over half of the firms surveyed in December expect their shipments and orders to increase during the next six months, and around one in ten expect decreases. On balance, area manufacturing firms are scheduling increases in capital spending and planning to add employees. Although current conditions vary among the region's major manufacturing sectors, the outlook for the first half of the year is positive in almost all of them.

Third District manufacturers continued to report rising prices, with about the same percentage of firms noting increases during December as in November. During the next six months almost two-thirds of manufacturers expect increases in input prices, and about one-half expect increases in the prices of their own goods.

Retail

Retail sales of general merchandise during the holiday shopping period were generally in line with merchants' expectations. Most stores reported year-over-year gains of around 3 percent, in current dollars. Stores specializing in luxury goods did better than other types of stores during the period, as they did through most of 2004; some posted year-over-year gains in excess of 10 percent. Merchants indicated that the extent of price markdowns in December and early January was roughly comparable to discounting in the previous year. In general, merchants reported that their inventories after the holidays were not excessive. Store executives forecast modest growth in sales during 2005. Those who commented on expansion plans generally indicated that they will open as many new stores this year as they did last year.

Auto dealers in the region reported roughly steady sales in December, on balance, although results varied by dealership. In general, dealers selling domestic makes saw some slowing in sales, and dealers selling imports saw increases. Although manufacturers have maintained promotions on 2004 models and extended them to 2005 models, many dealers' inventories remained above desired levels. Dealers expect sales this year to be off at least a few percent from last year.

Finance

Outstanding loan volume at Third District banks rose in December, according to banks contacted for this report. Commercial and industrial loans have been growing, with new borrowing being done by firms in a wide range of industries. Banks also reported increases in consumer lending, including credit card and home equity lines. Banks generally indicated that growth in home mortgage lending has slowed. Bankers in the District expect overall lending to rise in 2005. They anticipate further gains in business and consumer lending, but little growth in residential mortgage loan volume.

Investment companies and stockbrokers in the region have been receiving strong cash inflows, and most of the money has been directed toward equities. In response to the greater volume of business, some securities firms are adding employees and increasing their information technology capacity. Investment company executives expect business to continue to expand this year, but they do not expect stronger growth in 2005 than in 2004.

Services

Most of the Third District service firms contacted for this report indicated modest improvement in business conditions in the past few months, and some reported recent pickups in the pace of growth. Information technology companies indicated that demand for their services has strengthened as the result of improvement in their clients' business, an increase in information systems requirements to support regulatory compliance, and a growing need to upgrade computer systems generally. Other business services activity has been on the rise, and the pace of growth has increased somewhat. Most of the service sector firms surveyed expressed cautious optimism that growth in business this year will be stronger than last year.

Employment agencies in the region reported moderate increases in demand for workers in the past few months, and they expect the pace of hiring to be steady through the winter. Companies in manufacturing, trade, and the financial sectors have relatively stronger hiring plans than do employers in other sectors.

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Fourth District--Cleveland

For the final six weeks of 2004, economic conditions were mixed across major sectors of the Fourth District. Retailers' reports varied by retail segment, while activity among the District's durable and nondurable goods facilities was steady. Though residential and nonresidential construction continued to slow somewhat, the slowdown was probably partially due to seasonal variation. And while borrowing from banks in the District remained steady, demand for shipping services was "surprisingly strong." In general, input cost increases were modest and retail price pressures remained limited. Finally, staffing services companies reported an increase in demand for workers from manufacturing firms.

Manufacturing

Production at the District's durable goods manufacturers was generally steady at a high level toward the end of 2004. Some small declines were reported, but seemed to be the product of a seasonal slowing in demand. Automobile industry suppliers reported slowing sales at year-end, and domestic steel producers acknowledged that, aside from seasonal fluctuations, inventories have risen somewhat. Nevertheless, most manufacturers reported higher levels of production than at this time last year. And though growth in new orders was weak, firms' expectations for the future improved in December. In addition, unlike in recent reports, several firms reported that they plan to hire in the coming months.

Nondurable goods makers generally reported that production levels were flat for the last six weeks of 2004. Some firms also reported a rebound in production in January, but noted that this may be from seasonal fluctuations in demand. Production levels were reported to be the same as or less than at this time last year. Regarding expectations, several chemicals producers expect the economic environment to improve in the near term; however, paper producers were less sanguine in their assessment of the outlook. Most firms indicated that they had little intention to hire in the coming months, or to add to their capital stock.

Input costs continued to increase in recent weeks for nearly all nondurable goods makers, and they are also higher on a year-over-year basis. By contrast, durable goods producers generally reported that their input costs were flat throughout the recent period, though their costs also remained above year-ago levels. Finally, many durable goods producers reported rising wages and indicated continued concerns about increasing health care costs.

Retail Sales

The economic environment for retailers in the District was mixed, with some retail segments seeing strong gains and other reporting disappointing December sales. For some firms, this year's holiday selling season was worse than last year's, which itself was weak. Some contacts suggested that poor weather in the Midwest may have been a factor.

Sales at District department stores were generally weak, while sales at specialty apparel shops were more mixed. A few firms noted strong sales in early January, though these firms indicated that they were sharply discounting some of their merchandise. In particular, apparel retailers reported aggressive promotional activity in the wake of sluggish sales. Discounters reported sales growth that was consistent with their expectations. And grocers reported strong sales during the holiday season, while restaurateurs reported weaker conditions. While personal care products generally sold well, furniture and other home products sold poorly.

Sales at auto dealerships improved in December after a weak November. New automobile sales strengthened throughout the month of December, as dealerships employed discounts and incentives in an attempt to move merchandise. Nevertheless, dealerships generally reported that their inventories of new cars remained above acceptable levels. Used car sales were generally flat for the last six weeks of 2004.

Construction

Residential builders reported continuing declines in activity, often exceeding the expected seasonal slowing in sales. Building activity also appeared to be down from the levels of this time a year ago. Big builders discounted prices and provided incentives in an attempt to spur buying, but sales stayed weak throughout the District, especially in the Columbus and Cincinnati areas. Overall, builders' costs remained flat for the most part in December. Regarding hiring, several builders said that they have reduced or will reduce workforce sizes, as the expectations for future sales have diminished: Most builders expect 2005 sales to be below those in 2004.

Accounting for the usual seasonal slowing in activity, nonresidential construction was largely flat throughout the last six weeks of 2004, though customer inquiries improved modestly during December. On a year-over-year basis, building activity saw a slight increase. Regarding specific sectors, education-related construction remained robust at year-end, and several contractors also indicated increasing demand from firms in the manufacturing sector. Input prices for nonresidential builders have been flat for several months. Few firms expected to add to their workforces in the coming months, and most contacts think that activity in 2005 will be at least as strong as in 2004.

Banking

District banks described loan demand as steady, in general, throughout the six weeks ending 2004. While many smaller banks experienced a slight slowdown in commercial borrowing, they attributed this primarily to seasonal factors. Larger banks reported moderate improvement in their commercial clients' borrowing. Banking contacts generally characterized consumer borrowing as flat. Across all borrower sectors, most contacts reported that their delinquency rates remained low. Deposit growth differed across District institutions, with banks describing the deposit market as "very competitive."

Trucking and Shipping

Demand for trucking and shipping services remained strong through the six weeks ending 2004. In fact, a number of contacts characterized conditions as "surprisingly strong." Though demand continued to come from an array of sectors, manufacturers were noted as having especially high demand. And while fuel prices fell in recent weeks, shipping firms' fuel surcharges continued to protect them against any adverse fluctuations in fuel expenses. Companies continued their attempts to add to capacity through new truck purchases. The increase in demand for new trucks has created long lead times for their delivery. Companies also continued attempts to add to their payrolls by raising wage rates, as well as offering prospective personnel nonpecuniary enticements.

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Fifth District--Richmond

The Fifth District economy expanded at a quicker pace than in our last report, led by firmer conditions in manufacturing and an increase in retail activity in late December. District retailers generally reported that sales growth picked up the pace after mid December and was particularly strong in the final week of the month. Services providers reported moderate growth in both revenues and employment, and major services sectors such as real estate and tourism remained strong. Despite continued contraction in textiles, overall District manufacturing output was little changed in December after having dipped in November. Bank lending was also generally steady in the period since our last report. There were fewer reports of spiraling raw materials prices in the manufacturing sector and prices of manufactured goods rose only modestly. In agriculture, small grains and livestock were in good condition in most areas of the District.

Retail

District retailers reported that a surge in sales in the final week of the month offset sluggish activity early in the month, boosting their December revenues. A manager at a department store in central North Carolina said holiday revenues were strong. Sales at building supply stores were notably higher--a contact in Richmond, Va., said customer traffic picked up in December while a retailer in Columbia, S.C., reported record sales for the month. Most automobile dealers in the District reported increased sales in December. Stronger sales led retailers to increase hiring, and wage growth accelerated. Respondents said that prices rose only modestly at stores in December.

Services

Demand at services firms was somewhat stronger since our last report. A financial services contact in Baltimore, Md., said the general outlook of "the man on the street" had brightened. A commercial and residential landscaper in coastal North Carolina said his business had "done a 180" in the last four weeks, and that sharply higher customer demand was helping to rein in excess inventory accumulated earlier in the season. Despite the pickup in demand, services employment rose at a slower pace in December, though wage growth gained strength. Prices in the services sector grew at a slightly slower pace in December.

Manufacturing

District manufacturing activity stabilized in December after slipping somewhat in November. Factory shipments and new orders were flat while manufacturing employment edged higher. Several sectors reported generally higher levels of manufacturing activity but these gains were tempered by continued weakness in the textile and apparel sectors. A rubber products manufacturer in South Carolina, for example, told us that December sales were "better than forecast" and added that sales "looked good for the next 30 to 60 days." A plastics manufacturer in North Carolina reported "activity is good" and that "backlog, sales and work activity" were all up at his company. But textile and apparel producers reported softer new orders and lower employment in December. Textile and apparel firms expressed concern that the removal of textile and apparel quotas on China could constrain orders in 2005. Prices of raw materials and finished goods rose at a slower pace in December. Looking ahead, though some manufacturers expressed skepticism about the sustainability of the U.S. economic recovery, many said they planned to increase capital spending over the next six to 12 months.

Finance

District bankers reported that loan demand changed little since our last report. Lenders said that demand for commercial loans slowed in December, but the slowdown was about normal for the holiday season. Several commercial bankers noted modestly higher capital spending by their clients, particularly for new equipment, and expressed optimism that increased capital spending would drive commercial lending activity higher in 2005. In addition, there were scattered reports of stronger commercial real estate lending in Virginia. Residential mortgage lending was only modestly higher, however; new mortgage originations rose, but refinancing activity dwindled. Bankers reported little change in loan standards for creditworthiness since our last report.

Real Estate

Fifth District real estate agents continued to report generally strong housing markets. In Fairfax, Va., an agent said properties were being "snapped up" as soon as they hit the market, adding that she expected an even stronger market in the spring. A Fredericksburg, Va., agent reported a "still crazy" market there, noting that business at her agency was double year-ago levels. In Greensboro, N.C., an agent reported an "active market" and said that the future was expected to be even brighter as a new computer manufacturing facility brought additional jobs to the area. There were a few softer markets, however; agents in Odenton, Md., and Greenville, S.C., for example, reported some slowing in the pace of home sales. Home prices continued to rise in most areas of the District.

Commercial real estate agents reported that commercial leasing activity strengthened over the final six weeks of 2004. "We ended the year on a very strong note and are quite optimistic we can maintain that momentum well into 2005," noted a contact in Charlotte, N.C. Office leasing was the driving force behind the recent surge in activity as retail and industrial leasing were generally flat. An agent in the Washington, D.C., metropolitan area reported that the uptick in office leasing was due primarily to the expansion of "large companies into large spaces." There were scattered reports of increased office construction across the District, while the pace of retail construction was reported to be moderating. Rents and vacancy rates in the commercial sector were little changed.

Tourism

Tourist activity picked up in the weeks since our last report. A contact on the Outer Banks of North Carolina noted that unseasonably warm weather in late December and early January had boosted their business. A contact in Myrtle Beach, S.C., reported that some hotels were booked to capacity and were turning tourists away during the week after Christmas. Reports from mountain areas were generally upbeat as well. Contacts at mountain resorts in Virginia said that declining gasoline prices in December had helped their business and also noted that they were seeing more visitors from outside the United States.

Temporary Employment

Employment agents in the District generally reported flat demand for temporary workers since our last report. An agent in Raleigh, N.C., said that demand for workers had been slowed by the holidays in December; however, he looked for a pickup in hiring in 2005. An agent in Hagerstown, Md., also expected demand for workers at his agency to strengthen as the economy continued to grow. Workers with administrative and sales skills and those with production or distribution center experience were most highly sought.

Agriculture

Warm weather in early December accelerated the growth of late-planted winter grains and extended the grazing period for livestock in Virginia and West Virginia. Small grain crops were reported to be in mostly good condition in most areas of the District. But the last week of December brought very cold temperatures across the District and a snow storm along the Atlantic Coast, leading to unusually large amounts of supplemental feeding of livestock in Virginia and West Virginia.

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Sixth District--Atlanta

Sixth District business contacts reported that the pace of economic activity increased during late November and December. Most retailers conveyed that holiday sales were up modestly from year-ago levels, while auto sales rebounded somewhat. Travel and tourism contacts noted healthy seasonal activity, with the strongest results coming from Florida. Reports from manufacturers were mostly positive and capacity utilization continued to increase. According to contacts, housing markets in many parts of the District continued at high levels, while commercial markets noted small improvements. The demand for labor continued to increase, and reports noted a shortage of skilled workers in some industries. Contacts reported that prices were largely in check, although increases for building supplies and health insurance were exceptions.

Consumer Spending

Retail contacts indicated that holiday sales were up modestly compared with last year. Retailers in several Florida locations reported that they benefited from strong tourism over the holidays. Intense competition among merchants led to more widespread discounting, but most contacts noted that fourth-quarter profit margins equaled or exceeded last year's results. Electronics, jewelry and women's apparel sold well across much of the region, while home-related products sales were mixed. Most retail contacts anticipated modest sales growth in the first quarter of 2005.

District car dealers were encouraged by improved sales at year-end. This improvement was largely attributed to extensive promotional programs. Sales of District assembled models were mixed, with transplanted foreign brands outperforming domestic brands.

Real Estate

Contacts reported that District housing markets displayed strong levels of activity during November and December. In many markets, construction and sales of new homes posted gains, bringing them close to year-ago levels. New housing construction continued to pick up in Florida following delays caused by the hurricanes. Both builders and Realtors in Florida noted shortages of homes for sale. Nonresidential construction remained at low levels, but there were scattered reports of increasing industrial development. District office markets continued to recover very slowly.

Manufacturing and Transportation

Reports from the factory sector were generally positive and most contacts noted increased utilization of operating capacity in late November and December. Manufacturers of construction materials and steel were operating at especially high levels of capacity because of strong demand. Contacts noted increased output for pulp and paper producers, and reports from carpet producers and the defense sector were positive as well. Less positively, a computer circuit board manufacturer plans to cut 525 jobs in response to strong competition from Asian producers and a machine tool firm reported a decline in new orders. District trucking contacts continued to report increasing demand for freight services at year-end. In addition, the ports of Savannah, Brunswick and Jacksonville posted double-digit gains in both inbound and outbound shipping and Miami and Atlanta airport cargo tonnage was higher than year-ago levels.

Tourism and Business Travel

Industry reports suggest that the District's tourism industry performed well in late November and December, and the outlook remained positive for the rest of the winter season. Increased attendance at Florida attractions was reportedly boosted by a rise in foreign visits. Central Florida theme parks were filled to capacity and restaurants and hotels have increased hiring. Repairs to tourist facilities in hurricane-damaged areas continued. In Nashville, hotel room tax collections were running more than 8 percent ahead of 2003 and bookings suggested the strongest December in four years. Some District cities have also recently emerged of improvement in the business meeting and convention sector. Bookings of the exhibit space at downtown Atlanta's Georgia World Congress Center are up notably from a year ago.

Financial

Reports from financial institutions were mostly positive in late November and December. Consumer loan demand remained steady at strong levels and delinquency rates remained low. Commercial loan demand improved marginally but remained at low levels overall. Asset quality remained strong across most of the District, and insurance proceeds and federal loans boosted deposit levels in parts of Florida. Reports indicated that venture capital spending was increasing in some areas.

Employment and Prices

According to contacts, labor markets improved in late November and December. Several manufacturers reported that they were adding workers and some reported difficulty finding qualified staff. Commercial and residential builders reported that subcontractors, such as carpenters and roofers, were especially hard to find. Contacts in some parts of the District also reported that demand for workers in technology service industries has improved.

Rising building supply and healthcare costs continued to be widely reported. According to most reports, price increases for building materials were being passed along to homebuyers. Several business contacts noted that a larger share of the increase in health insurance costs was being passed along to employees than a year ago. Fuel surcharges continued to be used by transportation firms.

Agriculture

Weather patterns fluctuated markedly in late November and December, but no major impact on District crops was reported.

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Seventh District--Chicago

The Seventh District economy continued to expand at a moderate pace around the turn of the year. Consumer spending remained relatively soft, but business spending continued to pick up. Construction and real estate activity experienced a typical seasonal lull. Manufacturing output was steady at robust levels, and new orders were still strong. Bankers said that demand was down somewhat for household loans, but up slightly for business loans. Tight margins persisted, but retail price increases were largely subdued. The farm sector continued to profit from sales of bumper crops and relatively stable livestock prices.

Consumer spending

Consumer spending
On balance, consumer spending was again fairly soft in December and early January. Most retailers said that holiday sales were at the low to mid range of their expectations, as a strong finish to the shopping season largely offset a relatively weak start. Sales of electronics, jewelry, and entertainment goods (movies, books, music, etc.) were strong, while sales of appliances were weaker. Apparel sales picked up as the weather cooled in the region. Merchants also suggested that solid increases in gift card purchases will likely boost January's sales results. District auto dealers reported better-than-average light vehicle sales in December, although results varied greatly by make and model. Light vehicle inventories remained somewhat bloated. Some dealers noted a slight pickup in service and body shop sales from weak levels. Tourism and travel was mixed, as contacts in Wisconsin and Illinois reported increases from the previous year, but those in Michigan noted declines.

Business spending
Business spending continued to increase modestly. Most firms surveyed indicated that they planned to increase capital outlays in 2005 from 2004 levels. Of those that planned to increase spending, most had already begun to place orders for those outlays. The remaining firms said they would begin placing orders in the first half of the year. Airlines suggested that business travel held up in December, especially on international routes. With regard to hiring, temporary help firms reported a normal seasonal slowdown in December's orders. Still, year-over-year growth remained solid. Demand for professional and technical workers was said to be stronger than other categories, while it was weaker for office and clerical workers. Fees for temp-to-perm conversions and permanent placements continued to rise. Outside of the temporary help industry, fewer contacts reported new permanent hiring, but fewer also indicated that they were laying off workers.

Construction/real estate
Reports on construction and real estate activity were mixed. Realtors and builders in many areas noted a typical seasonal slowdown in December, while some reported a slight pickup in activity during the first week of January. Nonresidential activity also experienced a seasonal lull during December. Despite a slowdown in leasing activity last month, some office markets saw significant net absorption for the quarter as a whole. However, contacts in the Chicago area said that the office market remained soft, with little net absorption. In general, office rents remained under downward pressure, though one contact reported that landlords in a "smattering of markets" were able to increase rents modestly in the fourth quarter after several years of decreases. Leasing and construction of light industrial space picked up somewhat and retail activity remained strong.

Manufacturing
Manufacturing output was relatively steady in December, at high levels. Steel production was solid, although producers reported a slight slowdown in December. However, worldwide demand for steel products remained strong and contacts expected production to increase in coming months. Machine tool makers indicated that new orders and shipments were strong, with one firm adding that business was "the best it has been in years." Production of heavy equipment remained strong in December. One producer of heavy capital equipment indicated that production and shipments in December were buoyed by expiring tax incentives; looking ahead, this company's order backlogs had eased and its inventories were slightly higher. One contact in the heavy truck industry noted that "the window to replace the fleet before the 2007 change in environmental regulations is closing," with order books already filled for the first half of 2005. Trailer orders were reportedly strong as well. Nationwide light vehicle sales exceeded expectations in December, which helped bring inventories down to more desirable levels. However, inventories were still high and some automakers cut their production plans for the first quarter.

Banking/finance
Overall lending activity was slightly softer in December than during the previous reporting period. On the consumer side, one large bank reported slower growth in revolving credit, and many other banks said that mortgage lending had decreased. Margins continued to be squeezed, especially for mortgages. Standards and terms on the household side were largely unchanged, and quality was stable in most areas at good levels. On the business side, lending was still sluggish, although some bankers reported very slight increases in loan volumes. A contact with one large bank, however, noted a pickup in loan applications in the pipeline, which may boost volumes in coming months. Margins were still thin on business loans, standards and terms were largely unchanged, and loan quality continued to improve.

Prices/costs
Overall cost and price pressures remained in check at the end of 2004. Broad-based wage gains remained very modest, though increases were greater for workers in professional and technical occupations. Manufacturers reported that materials cost pressures eased somewhat toward the end of the year, but were still intense. Moreover, input costs were not expected to decline much further in the first quarter, and some were even expected to rise again. Some retailers plan to increase prices on selected merchandise (notably appliances and toys) to offset cost increases. However, many contacts said that the retail environment remains too competitive to increase prices substantially.

Agriculture
Agricultural contacts reported that farmers were upbeat. Net farm income jumped last year as a result of profitable livestock operations and record corn and soybean harvests, much of which was forward-contracted at unusually high prices. Farm income was also supported by federal loan deficiency payments, which are tied to spot market prices. The biggest problem reported was the slow movement of crops stored in the open air, which can be damaged by precipitation. Yet few storage facilities were under construction, which one contact thought was due to the large increases in steel costs. Farmland prices again moved higher amidst continued strong demand from non-farm investors and recreational buyers.

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Eighth District--St. Louis

Economic activity in the Eighth District continued to expand since our previous survey. A majority of manufacturing contacts reported plant openings, expansions, and new hires. The services sector continued to expand. Retail sales increased in November and early December compared with last year's levels. Reports of auto sales were mixed. Residential real estate activity continued to increase, and commercial activity showed additional signs of improvement, especially in construction. Total loans at a sample of small and mid-sized District banks increased from late September to early December.

Manufacturing and Other Business Activity
Manufacturing activity in the Eighth District has improved in many areas since our previous report, with a majority of firms reporting plant openings, facility expansions, and new hires. Several firms in the packaging materials, printing, primary metal, nonmetallic minerals, machinery, software, transportation equipment, and automotive parts industries reported plans to open new plants and expand production facilities in the District, which will likely result in more than 660 new jobs. Other firms in the machinery, transportation, primary metal, chemical, motor vehicle, automotive parts, fabricated metal product, and food industries reported plans to increase capital investment and hire as many as 880 new workers. Counteracting these improvements somewhat, several District manufacturers reported plant closings and workforce reductions. Firms in the fabricated metal product, wood product, chemical, and apparel industries will close plants and lay off employees, displacing as many as 1,290 workers.

The District's service sector continues to improve in most areas. Firms in the business support, freight transportation, insurance, airport operations, traveler accommodation, recreation, and employment services industries reported new facility openings and expansions, likely resulting in more than 500 new jobs. In contrast, a firm in the credit intermediation industry reported plans to eliminate 200 jobs due to a nationwide industry slowdown. District retailers generally reported increased sales in November and early December compared with the same months last year. Electronics and clothing were among strong-selling items. Auto dealer reports have been mixed, with new vehicle sales slowing as used vehicle sales continue to increase.

Real Estate and Construction
Home sales in the Eighth District continued to do well in November. November year-to-date sales increased by 14.8 percent in Memphis, compared with the same period in 2003. The increase was 6.6 percent in Louisville, 12.8 percent in southern Indiana, and 3.3 percent in the greater St. Louis area. November year-to-date housing starts grew by 6.7 percent in Memphis and fell by 11.7 percent in the Tupelo region compared with the same period in 2003. November year-to-date single-family housing permits were up in most of the District's metropolitan areas compared with the same period last year; in the St. Louis metropolitan area, permits increased by 12.5 percent. Contacts in northeast Arkansas reported that residential construction in November was very strong.

Commercial real estate markets at the end of the year seemed to be strengthening throughout the District. The St. Louis metropolitan area's year-end office vacancy rate fell to 16.0 percent, compared with 17.5 percent at the end of 2003, while the industrial vacancy rate fell to 5.6 percent from 7.4 percent in 2003. Contacts in Memphis expect commercial real estate activity to pick up in 2005. Commercial construction continued to show some improvement in most of the District. Contacts in west Tennessee report that commercial construction has improved and government construction has increased considerably. Contacts in northeast Arkansas indicate that commercial construction was active, but not as strong as residential activity. Commercial development remained at a record high through November in the Tupelo region, with a year-to-date increase of 20.3 percent in new commercial space built, compared with November 2003.

Banking and Finance
Total loans outstanding at a sample of small and mid-sized District banks increased 3.2 percent from late September to early December. This increase stems from a 3.4 percent rise in real estate loans along with a 4.4 percent rise in commercial and industrial loans. Loans to commercial banks also contributed to the overall increase, with a growth of 118.8 percent. Loans to individuals continued to decline, dropping by 2.3 percent. Over the same period, total deposits at these banks increased 4.8 percent.

Agriculture and Natural Resources
A major snowstorm hit parts of the District in late December. Moderate temperature and rainfall have since melted the snow but left behind muddy fields and pastures. Since November, there have been confirmed cases of Asian soybean rust--a fungus that reduces yield--in a few counties along the Mississippi River in Missouri, Tennessee, and Arkansas. Its effect on next year's crop remains uncertain. Farmers report that the winter wheat crop is mostly in fair or good condition. December coal production in the District states was about 4 percent higher than a year ago. Coal production during 2004 increased by about 10 percent compared with 2003.

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Ninth District--Minneapolis

The Ninth District economy showed continuing signs of growth from late November through mid-January, especially in consumer spending, manufacturing, energy, and mining. Agriculture was mixed, construction was steady, and tourism was down. Employment grew slightly and wage increases were moderate. Price increases appeared for a number of products including pork, fertilizer, and some manufacturing and construction materials.

Consumer Spending and Tourism
Overall consumer spending grew. A major Minneapolis-based retailer reported same-store sales up 5 percent in December compared with a year ago, while a Minnesota-based electronics retailer reported same-store sales up 2.5 percent. Bank directors noted that jewelry sales were up significantly, while sales at discount stores were soft. A women's apparel chain based in Minnesota reported December same-store sales fell 7 percent compared with a year ago. Sales for snow removal and winter recreation products were down from a year ago in several areas of the district due to low snowfall levels.

District mall managers noted a solid holiday sales season and between a 10 percent and 45 percent increase in gift card sales over a year ago. December sales at a North Dakota mall were up about 7 percent in December from last year. In Montana a mall manager reported a 6 percent gain in traffic for December compared with a year ago. A manager at a Minneapolis area mall reported traffic was strong, while merchandise returns were relatively soft between Christmas and New Year's; total December sales were up slightly from a year ago.

Winter tourism activity was slow due to a lack of snowfall in several parts of the district. A tourism official in the Black Hills area of South Dakota reported that snowmobiling and cross-country skiing were down significantly due to a lack of snow. Two downhill ski resorts in central Minnesota reported November and December activity down slightly from a year ago. However, snowmobiling activity during the holidays was up in the Upper Peninsula of Michigan and far northern Wisconsin thanks to "lake effect" snow from Lake Superior. In addition, over 125,000 fans attended games at the Junior World Hockey Championship held in Grand Forks, N.D., and Thief River Falls, Minn., during late December and early January.

Manufacturing
Manufacturing activity increased. A December survey of purchasing managers by Creighton University (Omaha, Neb.) indicated strong manufacturing activity in the Dakotas and Minnesota. An ad hoc survey of manufacturers revealed that capital spending is expected to increase in 2005, primarily due to higher sales expectations. In Minnesota, several firms announced plans to expand production facilities, including a plastics part producer, a tooling company, a furnace company, and an agricultural machinery maker. In South Dakota, a cooling system manufacturer is opening a $7 million plant, and an emergency vehicle producer received a large order for fire trucks. In western Wisconsin, two shipbuilders proposed expanding production facilities, and a wood products company plans a major expansion.

Construction and Real Estate
Commercial construction was steady. Contracts awarded for large construction projects in Minnesota and the Dakotas during the three-month period ended in November were about even with a year ago. A building official in Duluth, Minn., reported strong nonresidential construction through 2004 and expects slight growth in 2005. Residential construction was down slightly from year-ago levels. Permits issued in November for new home construction in Minneapolis-St. Paul were down 20 percent from the same month a year earlier. Housing units authorized in district states during the three-month period ended in November were down 2 percent compared with a year ago. However, Sioux Falls, S.D., issued a record number of housing permits by year-end 2004. Home builders are expected to remain busy during the winter months in Duluth, Minn., according to a builders association representative.

Real estate sales were mixed. The market for industrial space improved dramatically in 2004, according to a commercial real estate firm. A large user absorbed 212,000 square feet of office space in downtown Minneapolis, although downtown St. Paul had a 25 percent vacancy rate, compared with 19.4 percent a year earlier. The number of homes sold in Minneapolis-St. Paul in November was about 16 percent higher than a year earlier, with particularly strong demand for condominiums.

Energy and Mining
Activity in the energy and mining sectors remained strong. The Bureau of Land Management reported a record high price for oil and gas lease rights for a parcel of land in Montana. Meanwhile, mining companies are expanding production. Iron ore production was up, and additional investment was under way. A Montana mining official noted increased activity at most mines and said some mines have to wait for additional machinery, as new equipment orders may take up to two years to fill. There is increased interest in starting mining operations across the district.

Agriculture
The agriculture sector had mixed economic activity. The expected opening of the Canadian border to live cattle imports in March 2005 has some district cow/calf operators nervous about the effect on calf prices. Dairy producers are still enjoying strong prices for their products. The USDA expected Wisconsin December 2004 milk prices to average $17.40 per hundred pounds. Even though there is very little snow cover to protect against freeze or wind damage, the USDA rated 65 percent of the Montana 2005 winter wheat crop as good to excellent.

Employment, wages and prices
Employment grew slightly since the last report. Nonfarm employment in district states during November was 1.6 percent above year-earlier levels, the highest year-over-year increase since September 2000. A railroad hired more than 200 new workers in Montana during 2004. In North Dakota, a heavy equipment manufacturer will hire 100 workers; in northwestern Wisconsin, a transport company recently announced plans to add 162 new jobs over the next three years. A manufacturer of lubrication equipment recently said it will hire 40 workers in Sioux Falls. A representative of a placement firm for technology professionals in Minnesota expects the job market for information technology workers to steadily improve during 2005. Almost 20 percent of companies surveyed in Minneapolis-St. Paul by a temporary staffing agency plan to hire more employees during the first quarter of 2005, while 10 percent expect to reduce staffing levels.

In contrast, a Minnesota freezer manufacturer cut about 230 jobs in December, and a software company recently announced plans to lay off 75 employees. A paper mill in northern Minnesota intends to eliminate about 60 positions, and a mail-sorting operation will shut down in central Minnesota, laying off 24 employees.

Wage increases were moderate. A Minnesota state economist predicted that increases in real wages per job in the state will grow 2 percent in 2005.

Significant price increases were noted in pork, fertilizer, and several manufacturing and construction materials. Pork prices in November were up 20 percent from last year, while recent fertilizer prices were up 30 percent. Prices for steel, plastics, and copper were significantly higher than a year ago. While recent natural gas prices were above year-ago levels, prices decreased from the beginning of November to late December.

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Tenth District--Kansas City

The Tenth District economy expanded solidly in the period from late November to early January. Holiday retail sales were favorable, factory activity strengthened, and labor markets improved further. The energy and agriculture sectors also remained strong. Housing activity slowed slightly but was still high by historical standards, while commercial real estate markets generally remained weak. Wage and retail price pressures were still modest, but some price pressures persisted in manufacturing.

Consumer Spending
Consumer spending during the holiday season was generally characterized as solid. Most store and mall managers reported favorable year-over-year increases in holiday sales, with sales above plan at many stores. Overall, store managers reported that price discounting was similar to a year ago, although a few contacts said they resorted to heavy promotions to boost sales around Christmas. Sales of jewelry, other high-end items, and electronics were reported as especially strong this year. Many gift and specialty stores also reported robust sales. Apparel sales were somewhat mixed, with some stores reporting sluggish sales of winter clothing items due to unseasonably warm temperatures in early December. Inventory levels following the holidays were generally reported as satisfactory. Virtually all managers expect solid year-over-year sales gains in the near future, due in part to greater holiday sales of gift cards than a year ago. Motor vehicle sales in the district were reported as up slightly from the fall but basically unchanged from a year earlier. Most dealers were satisfied with current inventory levels and expect solid sales growth in coming months. Travel and tourism activity during the holidays rose solidly from a year ago. Airport traffic increased in most district cities, and activity at the Rocky Mountain ski resorts was strong, with some resorts reporting near-record levels of visitors.

Manufacturing
District manufacturing activity strengthened further. Most manufacturers reported increased production and orders since the previous survey, and employment continued to expand at many firms. A number of manufacturers continued to report difficulties obtaining materials, especially petroleum-based inputs, and expect some modest material availability problems to persist. Plant managers' expectations for future production remained strong, and many firms plan to continue to expand employment heading forward. In addition, many manufacturers expect to increase their capital spending in 2005, both to replace outdated equipment and to expand capacity. Among those firms not planning increases in capital spending, a commonly cited reason was the recent completion of a major capital project.

Real Estate and Construction
Housing activity slowed slightly but remained solid, while commercial real estate activity was still weak in most areas. Single-family housing starts edged down in many district cities but were still above last year's high levels. Builders generally characterized starts of both low-end and high-end homes as solid. Most builders expect some continued easing in homebuilding in the months ahead, though construction activity is expected to remain high by historical standards. Based on reports from real estate agents, home sales compared with recent months were basically flat for the district as a whole, with some cities reporting increases and others reporting decreases. Compared to last year's high levels, home sales were reported as being flat to slightly higher in most areas. Most mortgage lenders reported a decline in mortgage demand since the previous survey. Some lenders also noted a shift away from variable rate loans. Lenders generally expect some decrease in mortgage demand in the months ahead due to an anticipated further easing in demand for refinancings. Commercial real estate activity in the district generally remained weak, though some small improvements were reported in several mid-sized markets. Office vacancy rates edged down except in Denver and Kansas City, and prices for office space rose slightly in most areas as well. Most commercial real estate agents expect little significant change in office conditions in the next few months.

Banking
Bankers report that loans and deposits both edged up since the last survey, leaving loan-deposit ratios unchanged. Demand rose for commercial and industrial loans but was generally unchanged for other loan categories. On the deposit side, large CDs rose, while other types of accounts held steady. All respondent banks raised their prime lending rates since the last survey, and most banks also raised their consumer lending rates. Lending standards were generally unchanged.

Energy
District energy activity remained strong. The count of active oil and gas drilling rigs in the region was basically unchanged from the previous survey and still well above year-ago levels. Some contacts reported continued constraints on drilling due to labor and equipment shortages. With oil and gas prices still high, most drilling companies expect a slight expansion in drilling in the months ahead and are planning for solid increases in capital spending in 2005. Coal-mining firms also reported strong output growth in 2004 and anticipate another solid year in 2005.

Agriculture
Agricultural conditions generally remained strong. The winter wheat crop was reported to be in good condition across the district. In addition, preliminary assessments of farm incomes for 2004 indicate they will be up slightly from the record highs of 2003. Despite the higher incomes, few contacts expect large increases in capital investment this year because many producers made such investments last year. In addition, some producers in western parts of the district are worried that a possible lack of spring moisture could worsen already dry pasture conditions.

Labor Markets, Wages, and Prices
Wage and retail price pressures remained modest, while price pressures persisted in manufacturing. Labor markets continued to show improvement, as hiring announcements again outpaced layoffs. Even so, the percentage of firms reporting difficulties finding qualified workers remained similar to recent surveys--up considerably from a year ago but still much lower than five years ago. Worker shortages continued to be most acute in the energy sector, with one driller hiring rig workers from overseas in order to expand. Skilled factory workers, such as welders and metal fabricators, were also reported to be in short supply at some plants. Aside from these positions, wage pressures were still generally modest across the district. Most retailers reported flat selling prices compared with the previous survey and said that holiday discounting was similar to a year ago. Heading forward, a few retailers expect to raise prices modestly in order to pass on vendor price increases, but most managers anticipate little change in selling prices. Builders again reported moderate input price increases, though the increases were less widespread than in previous surveys. They generally anticipate further slight price increases heading forward. Many manufacturers continued to report rising materials costs, though fewer firms than in recent surveys did so. At the same time, a slightly higher percentage of factories raised their output prices or expect to do so in the near future.

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Eleventh District--Dallas

Eleventh District economic activity continued to expand at a moderate pace from mid-November to early January. While still mixed, manufacturing activity strengthened some, particularly for chemicals and energy-related products. Service sector activity was still strong, but there was some softening in demand for temporary workers. Retail sales were mixed, while construction and real estate activity picked up slightly. Energy activity continued to strengthen. Overall lending and deposit activity continued to grow, and credit quality remains stable. Agricultural conditions have been favorable.

Prices
Energy prices fell during the period but still remained relatively high in comparison to 2002 and 2003. Crude oil prices are down since November, and crude inventories moved above the five-year average in December, after being below the five-year average all year. Heating oil and retail gasoline prices have also fallen. Inventories of heating oil remained near the bottom of their five-year range, but inventories of gasoline returned to normal. Natural gas inventories are more than 10 percent above normal, and prices have fallen but remain very high compared to average prices in 2002 and 2003.

Manufacturers continued to be concerned about input cost pressures. Several industries said high energy prices have pushed selling prices up more than is typical for this time of year. Declines in the value of the dollar have increased the cost of some inputs, such as fabricated metals. Stiff competition is limiting the ability to pass along cost increases. Rising prices for coke, coal, steel and aluminum have led to slight increases in selling prices for some primary metals. Higher input costs for paper products have pushed up selling prices for toilet paper, tissues and paper towels, but stiff competition is putting downward pressure on prices of corrugated boxes. China's demand for aluminum has raised selling prices here, according to contacts. Rising cost pressures are also a concern for contacts in the service sector. Some firms are able to pass these cost increases onto their customers, but in other industries, contacts say stiff competition limits their ability to raise selling prices.

Labor Market
Labor markets remain quite soft overall, but appear to be slowly improving. Hiring continues to gradually strengthen in the service sector, with scattered reports of difficulty finding qualified workers in some occupations. Some manufacturing firms continued to report limited hiring or additional layoffs. Contacts in the lumber industry, however, report plans to increase employment.

Manufacturing
There were more signs of strengthening in the manufacturing sector from mid-November to early January. Demand for construction-related manufactured products has been stronger than usual for this time of year, partly because late fall rains pushed construction work into December. Lumber sales remained at high levels and producers of stone, clay and glass said demand was higher. Holiday demand for food products was stronger than usual, according to contacts, who said this was a very strong year for the food industry. District apparel manufacturers report no change in demand. Producers of paper and paper products also reported no change in demand over the past few weeks.

Sales growth increased slightly for semiconductor manufacturers. Producers noted continued gains in productivity and little overall job growth. Inventories were reported to be in good shape. Demand for consumer communications equipment slowed slightly at the end of the year after very strong growth in the first three quarters of 2004. Producers noted that demand for products, such as cell phones and personal communication devices, was strongest from markets outside the United States, such as from Asia and Europe. Demand picked up slightly for industrial communications equipment, such as switches and power sources, and growth is now about the same as a year ago. These firms say demand from businesses has improved recently but consumer activity has been unchanged over the past year. Further layoffs are anticipated as a result of investments in productivity-enhancing capital equipment.

Demand for primary and fabricated metals was unchanged from mid-November to early January. Sales of primary metals continued to be slower than in the third quarter--for some metals substantially slower. Contacts continued to cite lower levels of consumer confidence and foreign trade competition as possible reasons for slower activity, expressing concerns that China may become a net exporter of steel. While overall employment has been unchanged, employees are working shorter hours.

Chemical producers continued to report strong increases in activity. Domestic and international demand has been strong for chlorine, caustic soda, ethylene and olefin products. Contacts say that record exports were stimulated by gains in the price of oil relative to natural gas, as well as a drop in the value of the dollar. Demand for polyvinyl chloride (PVC) also remained strong, although rising ethylene prices have squeezed margins. A major new PVC and chlor-alkali complex was announced on the Gulf Coast, the first major expansion announcement since the late 1990s. Gulf Coast refiners have finally returned to high levels of operation following hurricane-related downtime.

Services
Temporary staffing activity softened slightly in the six weeks since our last report. Demand from light industrial manufacturing remained strong while demand for clerical workers slowed. Contacts said they are concerned about being unable to raise fees to completely offset an increase in their state unemployment tax rates. Demand for accounting services remained very strong. Activity was still mostly to support requirements of the Sarbanes-Oxley legislation. Contacts say firms are hoping to be more efficient complying with regulations this year because they have experience with the new rules. Accounting companies are still hiring "a lot of new people," and one contact said his firm had to turn away work for a lack of professionals to staff the project. Demand for legal services has been strong, driven by both transaction and litigation work. Hiring is up, and fees for legal services are rising, but not dramatically. Costs are largely unchanged, they say.

Railroads reported strong demand and rising prices. The trucking industry reported steady demand. Contacts say profits are being squeezed by high fuel prices and medical insurance costs because intense competition limits their ability to pass on cost increases to selling prices. Demand for air travel was up over a year ago, and airline industry contacts said planes have been flying fuller. Still, excess capacity is putting downward pressure on prices, keeping airlines focused on cutting costs to improve their balance sheet positions. Further layoffs are expected at some carriers.

Retail Sales
Retail sales reports were mixed. The Christmas season started slowly, but sales growth picked up as the holiday approached and were strong in the days after. Stiff competition and weak sales early on led to significant discounting at some stores, but other contacts reported good margins. Only a few retailers were left with excess inventory. Auto dealers reported sluggish sales and inventories are higher than desired. Selling prices and profits are down.

Construction and Real Estate
Demand for housing picked up from mid-November to early January, following a cooling that was reported in the last Beige Book. Realtors and home builders expect a slightly slower year in 2005, and remain focused on the need for job growth to stimulate activity. Multifamily contacts said Austin's market continues on the road to recovery, but Houston and Dallas' apartment markets have been overbuilt and may not see improvement until mid-2005. There is still a lot of vacant commercial space, but contacts said office leasing continued to pick up at a slow, steady pace.

Financial Services
Lending activity continues to increase, with the strongest loan growth in commercial and industrial categories. Mortgage lending is showing serious signs of slowing, according to contacts. Deposit growth was reported to be stable to good, and credit quality was unchanged. There are concerns, however, that credit quality could begin to suffer in a few quarters due to competitive rate pressures between the large number of banks in the larger Texas cities.

Energy
Land drilling has been mostly unchanged, but there was a pick up in offshore activity, with the number of rigs working in the Gulf of Mexico rising above 100 for the first time since a year ago. The increase is in oil-directed, deep-water drilling, with little change in shallow waters. Rates have been rising for deepwater rigs for several months, but long-term contracts have been limiting availability. Some contacts expressed the view that the recent leveling of drilling in the U.S. reflects a shortage of land rigs. Demand for oil services has increased with drilling. Contacts expect capital expenditures by oil producers to increase as much as 10 percent next year. Some contacts said such expansion plans might be constrained by shortages of equipment and/or workers with needed skills and that would lead to increases in the costs of these inputs rather than increased activity.

Agriculture
Soil moisture is adequate, but late fall rains delayed cotton harvest in the Plains, and cotton gins are expected to run through March, which is unusually late. Ranchers have expressed concerns about plans to re-open live cattle trade with Canada.

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Twelfth District--San Francisco

The Twelfth District economy continued to expand at a solid pace in late November and December. Contacts reported little or no pickup in the pace of overall price increases. The pace of cost increases for selected inputs eased, albeit from high levels. Several contacts noted that some of the higher input costs were passed on to consumers, though efficiency gains helped hold down overall production costs. Wages and salary pressures remained modest but up slightly overall. Strong export growth contributed to improving demand conditions in most sectors. Holiday retail sales, on balance, were up compared with last year, with retailers stepping up discounting in late December. Manufacturers, agricultural producers, and transportation and other service providers generally reported strong demand. Activity in District residential real estate markets remained robust, though it moderated in some areas. District banks reported overall solid loan demand and good credit quality.

Wages and Prices
The overall pace of price increases remained modest in recent weeks. District producers reported that, although the level of certain input costs remained high, increases in the cost of energy and building materials have eased from previous rapid rates. Several businesses indicated they were passing along at least some of the higher input costs to consumers. At the same time, several District businesses reportedly have experienced efficiency gains in their production processes, which served to hold down overall cost increases.

Contacts noted little change in labor market conditions. Reports indicated little or no difficulty filling positions, with the exception of certain high-skilled jobs in selected industries. Wages and salary pressures remained modest but up slightly overall; most District businesses reported that increases in benefits costs continued to push up total compensation bills.

Retail Trade and Services
Reports from District retailers indicated generally solid retail sales for the holiday season as a whole, with both dollar sales and unit sales up relative to last year. The strength of demand during the holiday season was broad-based across establishment types, with sales at discount stores, department stores, and establishments specializing in luxury products reportedly all performing well. Contacts noted that holiday season discounting was generally more restrained than last year, though many retailers increased discounting as the end of the season drew near. Perhaps as a result, sales performance was reported to have been considerably better toward the end of the holiday season than at the beginning. Overall, most contacts reported that holiday sales met expectations, leaving retail inventories in balance heading into 2005.

Sales of autos generally were solid during the survey period; foreign makes reportedly sold considerably better than domestic brands, despite the dollar's recent declines relative to other currencies. Final sale prices and profit margins remained restrained as a result of intense competition, particularly among domestic automakers.

District service providers reported a further strengthening in demand in recent weeks. For example, demand for health-care and transportation services was solid, and service providers operated at high utilization rates. District travel and tourism activity was healthy in most areas, with increases in both domestic and international traffic. In particular, the number of Japanese visitors to Hawaii have returned to pre-September 11 levels, boosting activity there. Hotel occupancy and average daily room rates continued to improve in many markets.

Manufacturing
Most District manufacturers reported strong demand for their products in late November and December. Increased foreign demand for various products contributed to overall improvements in business conditions. Makers of machine tools reported strong demand for most of their products; the market for certain inputs such as steel plates is characterized by tight inventories, strong demand, and rising prices. Robust construction activity continued to drive demand for wall board, insulation, and other building products in recent weeks. Robust demand conditions also characterized the food processing industry. Transportation equipment makers reported that demand conditions improved; new orders edged up slightly in recent weeks. In IT manufacturing, semiconductor orders and sales generally were solid; however, capacity utilization of chip makers dropped slightly from its already high level.

Agriculture and Resource-related Industries
District providers of agricultural and resource-related products indicated a strengthening in demand during the most recent survey period. Agricultural exports rose in recent weeks. District orders and sales of tree nuts especially were high, attributable in part to favorable public announcements regarding nutritional value and in part to constrained supply in other nut-growing regions. Contacts reported that prices for most agricultural products increased moderately in recent weeks. Overall, respondents indicated strong underlying demand for natural resources. Contacts reported a slight decline in wholesale prices for natural gas, while retail prices generally remained stable. On the other hand, consumers in the Pacific Northwest faced higher electricity prices as the effect of drought conditions on hydroelectric generation more than offset the effect of mild weather on demand.

Real Estate and Construction
Demand for residential real estate generally remained robust in recent weeks. Sales of new and existing homes increased throughout the District and home-price appreciation remained solid, particularly in certain areas such as Hawaii. However, in some areas the pace of home sales growth and price increases slowed from previous rapid rates. The overall robust demand for new homes and home improvements has kept overall construction activity at high levels. District commercial real estate markets generally improved in recent weeks; contacts reported that office vacancy rates continued to fall, and rents increased moderately in most markets.

Financial Institutions
District banking contacts indicated overall solid loan demand and good credit quality in late November and December. A very competitive environment generally has kept profit margins low in the banking sector recently, although several contacts reported that profit margins have improved. Commercial and industrial lending edged up slightly in recent weeks. Demand for construction, commercial real estate, and residential loans slowed a bit in some areas but remained at high levels overall. Several contacts noted increases in merger and acquisition activities among District firms.

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