June 16, 2004

Summary of Commentary on Current Economic Conditions by Federal Reserve District

Summary

Prepared at the Federal Reserve Bank of St. Louis and based on information collected before June 7, 2004. 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 Federal Reserve Banks indicate that economy activity in April and May continued to expand across the nation. Manufacturing activity continued to rise in most districts, with several districts describing the increases as broad-based. Most Federal Reserve districts reported increased demand for services. Retail sales remained even or rose in most districts. Residential real estate markets remained strong, and a few districts noted stable or improving conditions in commercial real estate markets. Bank lending activity increased in most districts. Conditions in the agricultural sector were reported as favorable, and the demand for agricultural products remained solid. Employment activity continued to improve, with hiring increasing at a faster pace in most districts; meanwhile, wages and salaries experienced little or muted upward pressures. Many Reserve Banks reported modest increases in consumer prices, but most districts noted rising prices of inputs, especially energy-related products, building materials, and steel.

Consumer Spending
The reports on overall retail sales in most Federal Reserve districts were generally positive. Sales were strong at discount and drug stores. Apparel and accessories, office supplies, food and other consumables, home products, and summer seasonal items were strong sellers in most districts. In contrast, sales of high-end electronics and appliances and specialty and gift items were soft in most districts. Districts reporting strong sales growth include New York, Philadelphia, Atlanta, and San Francisco. Minneapolis, Kansas City, Richmond, Chicago, and St. Louis reported slight to moderate increases in sales. Retailers in the Dallas district offered mixed reports of both strong and soft sales growth, while Cleveland reported sales about even with 2003 levels. Boston reported year-over-year increases, but noted that sales growth had slowed since the first months of this year. General retailers throughout the districts expressed cautious optimism about sales in the coming months. Retailers in the Boston, Philadelphia, Dallas, and San Francisco districts expressed concerns about the effects of increasing energy prices on sales.

Vehicle sales increased modestly in many districts and remained flat or slightly down in the others. San Francisco reported strong auto sales, attributing the continued strength to the availability of financing incentives. A number of districts noted that sales of light, fuel-efficient autos had increased; dealers in Philadelphia and San Francisco also noted that sales of trucks and sport utility vehicles had decreased because of rising gasoline prices. Minneapolis also reported strong sales, while dealers in Kansas City saw a modest increase; both districts noted that rising gasoline costs had not impeded sales of sport utility vehicles. In Dallas, Philadelphia, Cleveland, Richmond, Chicago, and St. Louis auto sales were flat or slightly up from 2003 levels. Atlanta reported sales growth in April, although sales are still below 2003 levels. In Philadelphia, Chicago, St. Louis, Dallas, and San Francisco auto dealers reported inventories above desired levels.

Manufacturing and Other Business Activity
Overall manufacturing activity increased in all Federal Reserve districts in April and May. Districts noted particularly strong growth in the defense, semiconductor, food processing, paper, lumber and other building products, textiles, automotive parts, furniture, heavy and other industrial equipment, metal products, transportation equipment, packaging, and recreational equipment and parts sectors. Districts reporting declines in activity in some sectors were Boston (home goods), Philadelphia (transportation equipment and food products), Richmond (furniture), St. Louis (paper materials and textiles), and San Francisco (commercial aircraft). Boston, New York, Cleveland, Atlanta, and Chicago reported intensifying cost pressures because of rising input costs, especially for steel and related products, petrochemical products, and wood products. Chicago and Cleveland reported robust demand for steel. Chicago also reported that steel producers' orders were booked for the foreseeable future and that heavier shipping volumes were leading to a surge in truck demand.

Activity in the services sector increased in most areas throughout the districts. Demand for freight transportation services increased in the Cleveland, New York, Richmond, Atlanta, Chicago, and St. Louis districts. Rising demand for trucking services, coupled with limited capacity, led some firms to announce new hires and capital expansions. In addition, transportation firms are more readily passing on cost increases from rising fuel and healthcare coverage costs to their customers. Tourism was up in most districts, including Boston, New York, Richmond, Atlanta, St. Louis, and San Francisco, although some contacts expressed concerns that rising fuel costs will dampen summer travel. Other services sectors reporting growth were the software and information technology, financial, insurance, healthcare, and telecommunications sectors.

Real Estate and Construction
Residential real estate activity remained robust in most districts. Home sales were exceptionally strong in the Richmond district, and Kansas City had sales in April and May that were much higher than the previous year's levels. Some areas in the San Francisco district had an increase in sales at a near-record pace. Home price appreciation was steady in Philadelphia ; however, contacts remarked that homes were taking longer to sell than earlier in the year. The New York district reported that the housing market was still strong but indicated that sales were leveling off in New York City. Single-family housing permits were up in most of the St. Louis district, as well as in the Minneapolis and New York districts. One exception was the Chicago district, where permits were down. Dallas reported a large increase in home construction, leading to a rise in inventories. Kansas City reported that the high-end market was weaker than the entry-level market, and in Chicago sales of both new and existing high-end homes softened. According to contacts in the Chicago, Dallas, and Richmond districts, "fence-sitters" were jumping into the market in anticipation of a rise in mortgage rates.

Commercial real estate markets were mostly slack, although a few districts noted signs of moderate improvement. Areas with continuing high vacancy rates, slow leasing activity, and low or flat rents in April and May were downtown Boston and the St. Louis and Chicago districts. One major exception was the Washington, D.C., area of the Richmond district, where leasing activity increased substantially in recent weeks. Leasing activity improved somewhat in the Philadelphia district. Contacts in Dallas were optimistic that commercial markets were recovering, particularly since industrial demand had increased slightly over the past six weeks. Contacts had a positive outlook for the near future in Atlanta and Kansas City, where vacancies are expected to decrease over the remainder of the year. Nonresidential construction activity was mixed. Although construction in Atlanta remained at low levels, the Minneapolis, St. Louis, and Cleveland districts reported some improvement.

Banking and Finance
In most Federal Reserve districts, lending activity increased. Only the St. Louis and Chicago districts reported that overall lending activity was flat. Atlanta, Cleveland, and San Francisco reported strong loan demand, while Philadelphia, New York, Kansas City, Dallas, and Richmond indicated a slight increase in loan demand. Mortgage loan demand remained strong in the San Francisco, Cleveland, Chicago, and Philadelphia districts, held steady in the St. Louis and Richmond districts, and fell in the New York district. The decline in refinancing activity reported in Philadelphia, New York, Chicago, San Francisco, and Richmond districts was often linked to the rise in mortgage interest rates. Only the Cleveland district reported strong refinancing. Deposits were flat in the Kansas City district, down in the Dallas district, and up in the Cleveland district. Lending standards were generally unchanged in the St. Louis, New York, and Kansas City districts; however, the Chicago district reported some lowering of standards because of competition.

Agriculture
Agricultural conditions across the nation were generally favorable. Recent rains have brought relief from drought conditions in the Minneapolis and Kansas City districts and have improved soil moisture levels in St. Louis, parts of Richmond, and Dallas, where contacts reported the most favorable levels in five years. However, heavy rains have necessitated the replanting of some acres in the St. Louis, Minneapolis, and Chicago districts. Spring planting was progressing ahead of the average pace in several districts, and demand for agricultural products remains solid. Minneapolis, Kansas City, Dallas, and San Francisco reported strong livestock prices. Dairy prices have increased in San Francisco, and Minneapolis expects record May milk prices in Wisconsin. Boosted in part by the weakened dollar, exports have increased in the Dallas and San Francisco districts. Dallas reported concerns about a possible negative impact of the preliminary World Trade Organization rulings against cotton subsidies.

Natural Resource Industries
Activity in the mining and energy sectors remains strong in the Minneapolis district, where oil and natural gas exploration and production increased slightly from mid-April. In the Kansas City district the number of active oil and gas drilling rigs rose slightly from the previous survey, but the expansion was limited by rising equipment costs and shortages of labor. Nonetheless, contacts in this district anticipate further increases in drilling, given the high energy prices. Meanwhile, the Dallas district saw little change in drilling activities, and its offshore activity remained weak. Contacts in San Francisco have experienced an increased demand for crude oil and natural gas and want to expand capacity, but are dealing with constraints in obtaining raw materials. Minneapolis reported that the iron ore shipping season was well under way.

Labor Markets, Wages, and Prices
Most districts indicated strengthening of labor markets. Boston, New York, Chicago, Minneapolis, St. Louis, Kansas City, and San Francisco reported increasing employment, plant expansions, and plant openings across several sectors, including manufacturing, construction, freight transportation services, and healthcare services. Richmond reported soft labor demand in the retail sector but stronger demand for temporary production and distribution centers, administrative, financial, and customer service workers in recent weeks. Manufacturing employment in the district continued to expand. In Atlanta, small businesses reported rising labor demand, as did firms in the construction, services, and automotive parts manufacturing sectors; layoffs continued in the apparel and industrial chemical sectors, however. Contacts in the Dallas district reported continuing weakness in the labor market but indicated that some firms were planning to hire new employees.

District reports indicated little or muted upward pressures on wages, although the rising cost of health insurance remained a key issue. The San Francisco and Kansas City districts noted that sufficient labor availability was leading to limited wage pressures. The New York and Dallas districts reported little pressure on wages, while the Minneapolis and Boston districts saw moderate increases in wages. The New York district noted scattered reports that starting salaries were rising in some industries. In the Boston district, contacts in the retail sector expect wages to increase. Manufacturing firms kept the wage rates of new hires stable in the Cleveland district. Contacts in the San Francisco and Dallas districts noted high costs of health insurance. Contacts in the trucking and shipping sectors in the Cleveland district also expressed concerns over health insurance costs.

Consumer price increases were generally modest, but most districts reported increasing input prices, particularly of energy-related products, building materials, and steel. Retail prices in the Boston, Philadelphia, and San Francisco districts remained generally stable and increased modestly in the Kansas City and Dallas district. Merchandise is being marked down less in the Cleveland district. Meanwhile, merchants have seen increases in vendor prices in the Cleveland and Philadelphia districts. In response to higher input prices, some businesses were able to push up prices to their end consumers in the Philadelphia, Cleveland, Atlanta, Chicago, Kansas City, and Dallas districts.

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First District--Boston

Business activity continues to gain strength in the First District. Retailers and manufacturers report growth in sales and orders. Demand for software and information technology services as well as temp workers is also rising. Commercial real estate markets may be stabilizing. With some important exceptions including energy and steel, input prices are mostly stable; selling prices are said to be moving up gradually. Wage increases are returning to the 2 percent to 5 percent range.

Retail
Most retail contacts in the First District report sales growth from a year ago in April and May. However, many respondents note a slower rate of increase than in the last few months. According to a department store and a high-end retailer, consumers are buying and spending more on "luxury" products, such as women's handbags and shoes. Apparel sales are said to be stronger than home-goods sales, and sales of durable and consumable office-supply products are up. Respondents in other sectors, such as furniture and electronic entertainment equipment, indicate sales are down or flat.

About two-thirds of the contacted retailers report lean inventories that are in line with sales, while the rest are trying to bring inventories down. Vendor prices and selling prices are mostly stable, though several contacts note price increases for European goods and on some commodity goods, such as paper and steel products. Although there are some pockets of growth, overall employment is steady; wages are expected to increase by 2 percent to 5 percent this year.

Travel and tourism in the Boston area has improved, with sales at hotels and restaurants increasing 6 percent to 7 percent this period compared to last year. According to respondents, corporate bookings continue to be strong, particularly in the biotechnology sector, and leisure travel is growing. While most visitors prefer to travel by car, new low-cost carriers at Logan Airport are expected to bring in more visitors in the upcoming months. International travel has also increased, with additional flights from London, Mexico City, Rome, Paris, and Frankfurt.

Retail respondents are generally anticipating sales increases over the next six months. However, they express concern about rising gas prices, homeland security issues, and geopolitical uncertainties.

Manufacturing and Related Services
Most First District contacts in manufacturing and related services report that sales and orders in the first and second quarters of 2004 have been ahead of year-earlier levels. Growth is particularly strong in defense- and semiconductor-related segments. Several companies report that they are doing better than they had anticipated as of late 2003. By contrast, a couple sellers of home goods report weaker-than-anticipated sales trends in the second quarter.

Many contacts report sharp cost increases for energy and steel, and some are facing higher costs for paper, petrochemical products, and hardwoods. Specialty steel is in short supply. Other materials costs are mostly flat to down. Many manufacturers and related services providers report that they have been able to increase their selling prices 1 percent to 3 percent or that deflationary pressures have become less intense. However, contacts selling to airlines, automotive companies, and prime defense contractors indicate continuing demands for price reductions.

About three-quarters of contacts in manufacturing and related services are increasing their U.S. headcounts a little. Pay increases are mostly expected to average 3 percent to 4 percent in 2004. A couple of firms are feeling pressure to raise pay for selected groups of employees more than originally planned. A majority of respondents are increasing capital spending this year, with IT featuring prominently in many companies' plans.

Most businesses have a positive outlook, with one saying its prospects are the best they have been in a long time and another saying the general business climate is more encouraging than it has been since early 2001. Some companies express concern that high energy prices and rising interest rates could damp consumer spending. Cognizant of their experience in the last cycle, firms in the semiconductor industry are trying to avoid an excessive expansion that would be followed by a sharp retrenchment.

Temporary Employment
Temporary employment firms in New England enjoyed improving business conditions in Q1 2004, continuing into early Q2. Demand for temporaries is up across a wide spectrum of industries, most notably manufacturing, and a number of respondents report increased demand for permanent employees. While labor supplies appear to be tightening, contacts say this is not yet a major concern.

Bill rates and pay rates are largely unchanged, with fewer reports of clients putting intense downward pressure on bill rates. Concerns about non-payroll related costs are also muted compared to three months ago, although contacts still report sharp increases in insurance costs.

Respondents are upbeat about the rest of the year, expecting labor demand to be higher than in the first five months. While concerns about terrorism and political uncertainty linger, increasing orders and growing demand for permanent hires have engendered optimism among most respondents.

Commercial Real Estate
The Boston area office market is flat, with few changes since the end of 2003. Despite some positive net absorption, vacancy rates remain between 12 percent and 15 percent downtown and above 20 percent in the suburbs. Rents continue to decline and contacts describe Boston as a "tenants' market," in which tenants can often negotiate rents below their listed values. While some contacts believe the office market will start improving soon, others fear that currently planned large corporate mergers could raise vacancies even higher. All agree that significant job growth will be required to start filling vacant space, because there is a lot of shadow space. On the other hand, real estate transaction prices for high-rise office buildings are exceptionally high, and demand for them has not diminished.

Commercial markets in the rest of New England are gradually gaining strength. The Cambridge office market has improved slightly during the past quarter. The apartment market throughout Massachusetts continues to perform well, reflecting the strong housing market. Providence is also strong, especially the retail and apartment markets. In the Hartford market, vacancy rates remain high, although there are no large blocks of office space available.

Software and Information Technology Services
The market for software and information technology services is becoming more brisk. Year-over-year revenue growth of contacts has "regained its momentum," ranging from 4 percent to 16 percent in the first quarter of 2004. Growth in health care software is steady; other sectors such as human resources software, banking software, network software, and more broad-based custom applications development are even stronger. Respondents say the improvement indicates corporate investment on information technology is picking up economy-wide. Large companies are growing faster than small ones, who say they are facing low-end competition, especially from staffing firms. Companies that export to Europe, Asia, and Canada report no significant stimulus from the weak dollar; all attribute their demand growth to the improving domestic market.

Software and IT contacts say employment is steady and the majority plans no new hiring in the near future. Capital and technology spending of most contacted companies is "moderate," with technology development the largest spending category.

With a strong order pipeline, most respondents are moderately optimistic. While expectations of revenue growth in the next quarter range from single to high double digits, some contacts express concern about potential effects of the Iraq war and the upcoming election on corporate IT investment decisions.

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Second District--New York

The Second District's economy has shown persistent strength in recent weeks. Although prices of finished consumer goods remain relatively stable, increasing cost pressures are reported in a number of industry sectors. The labor market has continued to improve, with only scattered reports of rising salaries in certain industries. Retailers report that sales were, again, ahead of plan in May, while selling prices were stable to slightly higher. Recent business surveys suggest ongoing growth in manufacturing, and the trucking industry sees increasingly strong demand and limited capacity; both sectors face widespread cost pressures.

The housing market remains robust, despite some leveling off in New York City's co-op and condo market. Residential construction has strengthened further, while widespread increases are reported in construction costs. Manhattan's office market was steady to firmer in May, led by brisk demand from financial, as well as publishing, firms. New York's securities industry has seen further increases in business activity and has reportedly stepped up hiring. Tourism-related industries in New York City again turned in strong results. Finally, bankers report a pickup in commercial loan demand and further declines in delinquency rates across the board.

Consumer Spending
Retail sales were characterized as strong and ahead of plan in May. Year-over-year same-store sales gains mostly ranged between 5 and 11 percent; one chain reports no increase, but attributes this to a shift in the promotional calendar. All contacts indicate that inventories are in good shape. Most contacts note particular growth in apparel sales across the board, but quite a few indicate noticeable slowing in sales of home goods. Retailers generally report that selling prices have been stable to up slightly in recent months, in contrast with the declines reported last year. Retailers cite continued escalation in health insurance costs but only modest increases in merchandise and labor costs; most report little impact from rising energy costs, which generally represent a small fraction of their budget.

Consumer confidence surveys were mixed in May. Siena College's survey of New York State residents shows confidence edging up in the New York City area, following a dip in April, but slipping to an 8-month low in upstate New York. The Conference Board's survey for the Middle Atlantic region (NY, NJ, PA) shows confidence retreating 5 points in May, after jumping 14 points, to a cyclical high, in April.

Construction and Real Estate
Home construction picked up in recent months, and housing markets continued to show strength in May, despite some leveling off in New York City. Both single-family and multifamily housing permits increased in April and, year-to-date, have been running well ahead of 2003 levels. More recently, New Jersey homebuilders report further strengthening in the housing market in May, with robust demand and a low supply of available homes driving up prices further. A local industry expert also reports significant cost pressures throughout the industry--notably on lumber, gypsum, and plumbing material, as well as land and transportation costs. While labor costs remain subdued, this contact expects upward wage pressure soon, citing emerging shortages of skilled workers.

The market for existing single-family homes remains robust. Over the past 12 months, prices have reportedly risen by 3-4 percent across most of upstate and western New York but by more than 10 percent in the New York City area and the Hudson Valley. Prices of Manhattan co-ops and condos have risen even more sharply in the past year, though contacts note that the market retreated in May, following a surge in both sales and prices in March and April.

Manhattan's office market has shown gradual improvement in recent months. Office vacancy rates were steady to slightly lower in April and May, after reaching a 1½-year low at the end of March, while asking rents continued to edge back up towards their 2000 peaks. An industry contact notes growing demand from financial services firms looking for more space, and, to a lesser extent, from publishers.

Other Business Activity
A major New York City employment agency reports a further pickup in hiring activity, most notably from the financial sector; the legal industry is also reported to be adding staff. Starting salaries are reported to be on the rise once again, but still below the peak levels seen in 2000. A securities industry contact reports that industry trends remain positive: overall activity is reported to be growing briskly in the current quarter, and year-end bonuses now appear to have risen by more than 30 percent--a larger gain than initially estimated. This contact also notes that the financial sector is seeing an upturn in costs for computer equipment and programmers.

Manhattan hotels and theaters continue to report strong business. After adjusting for seasonal variation, hotel occupancy rates climbed to a nearly four-year high in April, approaching 90 percent. Moreover, room rates accelerated, rising 10 percent from a year earlier, and reaching their highest levels since summer 2001. While statistics are not yet available for May, contacts continue to report brisk business. Broadway also posted strong results: in May, box-office revenues were up 9 percent from a year ago, while attendance was up more than 7 percent; this follows even stronger gains in April.

The district's manufacturers report continued strength. May surveys of purchasing managers in both the New York City and Buffalo areas did indicate moderation in the pace of improvement of business conditions, following widespread gains in the first four months of the year. However, manufacturing contacts in early June suggest robust growth. More generally, manufacturers continue to report intensifying cost pressures. Similarly, a trucking industry authority notes increasingly strong demand and limited capacity, which has enabled truckers to pass along fuel cost increases to their customers; surcharges and price increases are said to be fairly widespread. He further notes that a strike-related closure of a major regional trucking firm in late May could lead to some added disruptions to the industry.

Financial Developments
Small to medium-sized banks in the Second District report increased demand for commercial credit, steady demand for consumer loans, and reduced demand, again, for residential mortgages. Widespread declines are once again reported in refinancing activity. A large majority of respondents report no change in credit standards across all loan categories. Loan rates increased across all loan categories, most notably, for residential mortgages. Average deposit rates rose, on balance, though increases were somewhat less widespread. Finally, bankers report decreased delinquency rates across all loan categories.

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Third District--Philadelphia

Economic activity in the Third District continued to expand in May. Manufacturers reported increases in orders and shipments during the month. Retailers indicated that sales of general merchandise rose in May compared with April and with May of last year. Auto and light truck sales slowed a bit from April, according to dealers, but rose on a year-over-year basis. Banks and other lending institutions reported that overall lending continued on an upward trend, although mortgage refinancings have declined. Home sales continued to run at a brisk pace, but commercial real estate markets remained soft.

The consensus in the Third District business community is that the regional economy will continue to improve during the rest of the year. Manufacturers anticipate increases in shipments and orders during the next six months. Retailers expect sales in the second half of the year to exceed sales in the same period last year. Auto dealers are less optimistic, but they still expect this year's sales to be close to last year's. Bankers expect business and consumer lending to increase, but they anticipate a slowing in residential mortgage activity, primarily as a result of a decrease in refinancings. Real estate agents and home builders expect continued strong demand for homes, but contacts in commercial real estate see few signs that demand for space will strengthen appreciably this year.

Manufacturing
Manufacturing activity in the Third District continued to increase in May, although monthly gains were not quite as common among regional manufacturing firms as they were in April. Around four in ten of the firms surveyed in May posted higher shipments and orders compared with the prior month, and around two in ten reported decreases. Overall, there were small increases in order backlogs and delivery times at area plants. Firms in all the major manufacturing sectors in the region except transportation equipment and food products indicated that business conditions were improving. Increases in demand were especially strong for firms producing lumber products, furniture, chemicals, and metal products.

Manufacturing firms in the region continued to report rising input prices in May. Price increases for steel and steel products and for wood and lumber products were widespread. Manufacturers also indicated that these products were in short supply or subject to delays in delivery, limiting production rates. Nearly half of the manufacturing firms contacted for this report indicated they have raised the prices of their products since the beginning of the year. Price increases were most prevalent among makers of lumber products, furniture, stone, clay, and glass products, and metals and metal products.

The region's manufacturers expect further gains in business activity. More than half of the firms surveyed in May expect increases in shipments and orders, and less than one in five expect decreases during the next six months. Area manufacturing firms are scheduling increases in capital spending and are planning to add employees in the next six months.

Retail
Third District retailers generally reported continuing growth in sales during May. Most types of stores indicated that sales for the month were at least a few percent above last year's results. Several merchants indicated that their annual gain for May was somewhat below the annual gain for April; however, they said the year-over-year increase might have been limited because the late Memorial Day holiday this year tended to move some summer and vacation-oriented shopping into June. Sales early in June support this conjecture, according to some of the merchants contacted for this report. Merchants said summer apparel was selling well and luxury goods continued to be in high demand. Store executives indicated that inventories were in-line with the pace of sales.

Third District retailers expect sales for the summer to be above the same period last year. Most store executives said there does not appear to be a decline in customer traffic or purchasing that could be attributed to the impact of higher gasoline prices. With regard to other prices, some merchants said they have recently seen increases in the costs of some of the goods they obtain from domestic manufacturers. Retailers have not raised their own prices on a large scale, but some merchants noted that price markdowns have been curtailed.

Auto dealers reported a slowing in sales in May compared with April, although May sales appear to be above the year-ago result. Dealers indicated that sales of large sport-utility vehicles have sagged, but smaller, more fuel-efficient versions have been in increased demand. Inventories are generally above desired levels. Despite the uncertainty over gas prices, dealers in the region expect unit sales for the second half of this year to be close to unit sales in the second half of last year, although some speculate that smaller vehicles will make up a greater portion of total sales this year.

Finance
Outstanding loan volume at Third District banks rose in May, according to banks contacted for this report. Commercial and industrial loans were on the rise at commercial banks and nonbank lenders. Consumer credit and home equity lending have been growing also. Residential real estate lending has continued on an upward trend for home purchases, but refinancing activity has slowed. Some lenders noted a shift to second mortgages in lieu of refinancings by borrowers seeking to obtain credit for home-related expenditures.

Bankers in the District generally expect overall lending to rise during the rest of the year. They anticipate business and consumer loan volumes increasing further, but they expect some slowing in residential mortgage lending activity.

Real Estate and Construction
Commercial real estate firms in the Third District reported that leasing activity increased recently as many office tenants renewed expiring leases. However, there has been no increase in space rented. The overall office vacancy rate actually rose slightly in most parts of the District as new buildings came on-line. Most of the increased vacancies have been in older buildings as a large number of companies have moved into new buildings. The vacancy rate in the Philadelphia central business district edged up to around 14 percent, and the suburban vacancy rate remained above 20 percent. Commercial real estate firms expect construction activity to slow as a number of new buildings are completed this year. They also expect the additional space to keep vacancy rates from dropping quickly. Industrial building vacancy rates and rents have been nearly steady. There are signs of increased demand for industrial space, especially for warehouse and distribution facilities, but commercial real estate firms forecast only a minimal amount of new construction this year.

Residential real estate agents and homebuilders indicated that sales have been roughly steady in recent weeks and above the pace during the same time last year. Price appreciation appears to be steady, although some real estate agents noted that homes are now taking longer to sell than they did earlier in the year. Both builders and real estate agents expect sales to continue near the current pace unless mortgage interest rates move up significantly. Several contacts speculated that a 100 basis point rise would seriously slow home sales.

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Fourth District--Cleveland

The economic environment in the Fourth District remained strong through the six weeks ending in May. In the manufacturing sector, increases in production continued to be broad based, something that could not be said before the beginning of this year. And retailers reported steady conditions in recent weeks as well, though some store categories saw a slight slowing in sales since the beginning of April. Residential builders also saw slight declines in sales in late April and May, though homebuilders reported that the pace of building remains near the record rates of the previous year. Meanwhile, the pace of commercial construction has continued to gradually improve from low levels. In the banking sector, commercial loan demand continued to rise. Finally, trucking and shipping firms continued to report robust activity.

These signs of a strengthening economic environment, however, were accompanied by reports of rising input prices. Many of the firms that reported increases in input costs also reported that they remain able to pass input-price increases along to their end consumers. Finally, despite the steadily improving economic environment, many firms reported that their hiring is likely to be limited for the remainder of this year.

Manufacturing
Most District manufacturers reported that their production levels remained flat or rose in the six weeks ending in May. On a year-over-year basis, production levels also rose for a majority of manufacturers, particularly for durable goods producers. Domestic steel producers reported strong shipment volumes recently, and volumes are up significantly from the levels of a year ago, often on the order of 10 to 15 percent. While some steel producers reported running their plants near capacity, others noted that they have available capacity, but are constrained by shortages of raw materials. Outside of the steel-producing sector, capacity utilization continues to be below the levels that many firms would like. Regarding the outlook for the remainder of 2004, most manufacturers expect modest growth in the months ahead.

In general, a majority of manufacturers characterized their inventory levels as acceptable. Most manufacturers also reported the use of overtime recently, and about half of all contacts indicated that they had increased the sizes of their workforce. Nevertheless, many firms noted that their future hiring was likely to be limited. For those firms that had hired recently, wage rates reportedly remained stable.

Increases in input costs continued to be widely reported. Prices for petroleum-based products, steel, and aluminum saw among the sharpest increases. In some cases, however, contacts in the steel industry indicated that some surcharges have declined due to recently receding scrap prices. Other raw materials prices for steel producers are reported to be dramatically higher than at this time last year. Finally, more manufacturers are tending to report that they can pass at least a portion of increased input costs along to their customers.

Retail Sales
Reports from District retailers suggest that the economic environment remained steady in recent weeks. Specialty apparel stores and department stores reported some slowing in sales growth in the last several weeks, but this follows a period of strong sales gains in the early spring. On a year-over-year basis, sales at these outlets are said to be down slightly. Discount retailers, by contrast, reported slight sales gains in recent weeks. Sales for these firms are up from the levels of a year ago. Finally, the drug store category continues to be strong, as personal care items remain strong sellers.

As has been true since the beginning of this year, several retailers reported that merchandise is being marked down less and promotions are being offered less often. A few firms reported rising vendor prices, due primarily to increases in fuel prices. However, unlike in other sectors, most retailers continued to report declines in input costs.

After slowing a bit in April, District sales of new automobiles reportedly rose in May. Sales in the last several weeks appear to be about even with those from this time last year. Incentives are reported to have risen in recent weeks, as automakers attempt to reduce the amount of inventories at their dealerships. Used car sales are said to be steady.

Construction
Residential builders reported that sales slowed slightly in recent weeks. Builders serving the lower-price segment of the market, in particular, noted a decline in demand. Most contacts attributed this decline to recent increases in interest rates. Nevertheless, most homebuilders expect sales in 2004 to be similar to those in 2003, a record year for homebuilders. Costs continue to be a concern for residential builders, but many reported being able to pass a portion of these increases through to their final prices. Many builders reported that materials costs remained high, and that the costs of concrete and steel have risen in recent weeks as well. Finally, some subcontractors are said to be seeking increases in their compensation.

Commercial builders continued to report improving conditions, with some contacts indicating significant increases in customer inquiries in recent weeks. A few firms also reported that their backlog of orders is increasing. As a result, many commercial contractors are increasingly optimistic. However, like homebuilders, commercial contractors remain concerned about rising materials costs. Hiring remains limited in the industry.

Banking
In general, commercial loan demand continued to be strong in the six weeks ending in May, as it has been since the start of this year. However, the total volume of commercial lending by banks in the District is reported to be somewhat less than at this time last year. Consumer loan demand was characterized as steady in the last several weeks, and approximately a third of contacts indicated an increase in lending to consumers when compared with this time a year ago. New mortgage lending and refinancing remained strong, but have slowed in the last several weeks. In addition, most institutions reported seeing a decrease in delinquencies on both consumer and business loans. All contacts reported growth in core deposits, both in recent weeks and relative to this time a year ago.

Trucking and Shipping
Business conditions continued to be strong for firms in the trucking and shipping sector. Moreover, contacts reported that the demand for trucking and shipping services came from an array of industries. The strength of demand is such that firms continued to report that they are running their fleets near capacity. While rising input costs remain a concern for many carriers, most reported that they are able to pass these increases along in their prices. The most significant increases in input costs have been for fuel and health-care insurance coverage (which is up about 10 to 20 percent on the year). Outside of benefits costs, wage rates reportedly remain flat in the industry. Several firms reported that they are hiring new drivers, in part to replace retiring drivers, as well as in response to revised hours-of-service regulations.

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Fifth District--Richmond

Overview
The pace of expansion of the Fifth District's economy quickened in the weeks since our last report, with evidence of growth broadening into almost all sectors. Retailers and services firms reported stronger revenue growth in April and May and manufacturers said that factory output expanded further. Although hiring gains were limited at most District retailers and services firms in recent weeks, manufacturers expanded their payrolls more rapidly, providing further evidence of a turnaround in that sector. In the financial sector, activity was somewhat subdued. Commercial lending was sluggish, and higher mortgage interest rates crimped residential mortgage lending growth. In contrast, home sales in the Fifth District continued strong and commercial realtors reported a slight pickup in leasing activity in April and May. Although prices for some construction materials such as lumber and concrete moved sharply higher, overall price increases for raw materials used in manufacturing moderated somewhat in May. In agriculture, hot and dry weather in May stressed crops in some areas, but scattered rainfall in late May and early June helped alleviate hot, dry conditions in many areas.

Retail
Fifth District retailers reported that their sales grew moderately since our last report. A manager at a department store in the Washington, D.C., area reported that sales growth was "a little bit better" than six weeks ago, while another manager in the lowlands of South Carolina said, "We're holding our own." District grocery and specialty food stores reported increased sales, while automobile dealers gave mixed reports on sales. Some lumber and building supply businesses raised their prices to offset continued higher wholesale costs for selected wood or steel products. Despite generally better sales, retail hiring remained soft. Many retailers reduced staff and those hiring were only filling vacated or seasonal positions.

Services
Services firms reported improved demand in recent weeks. Brokerage and financial services firms in Baltimore, Md., central North Carolina, the South Carolina midlands, and several areas of Virginia all reported increases in customer demand. Transportation firms also said that customer demand had increased, even though shipping rates have risen to reflect higher gasoline costs. In contrast, demand for healthcare services across the District was mixed. Services sector hiring was mixed--many businesses said they were not adding employees, but a contact at a Washington, D.C., executive search firm said "things are really picking up."

Manufacturing
District manufacturing activity continued strong in April and May. Manufacturers told us that shipments and new orders rose in both months; output growth was particularly strong in the food, paper, lumber and textiles industries. A North Carolina-based producer of plastics noted they were seeing "good activity," which he attributed to a generally improved economic picture. The furniture industry remained one of the sector's softer spots--one District manufacturer said war news and stock market declines had slowed the demand for furniture. Reinforcing the generally positive tone of the sector, manufacturing employment and production workers' average workweek continued to expand in recent weeks. On the price front, raw materials and finished goods price increases moderated since our last report.

Finance
District bankers reported only modest growth in loan demand in recent weeks. Demand for commercial loans was said to be lukewarm; several contacts noted that new loans were resulting only from more exhaustive marketing efforts. A lender in Richmond, Va., said his clients were showing more confidence in the economy and were borrowing more for capital investment and mergers and acquisitions activity. Residential mortgage lenders reported a further slowing of home refinancing activity as mortgage interest rates moved higher in May. In contrast, contacts indicated that lending for new home mortgages was holding up. Most lenders said that credit quality remained good.

Real Estate
District realtors reported continued robust housing markets since our last report. Realtors described sales as exceptionally strong, and a contact in Richmond, Va., noted that he had received 11 contracts on a single property. A Fairfax, Va., agent also reported multiple contracts on some properties and added that buyers were frequently waiving inspections and appraisals, as well as offering to pay a portion of sellers' closing costs. A Greensboro, N.C., realtor said that rising mortgage interest rates in April and May had sparked a pickup in sales there, prompting fence sitters to commit to a home purchase ahead of anticipated higher mortgage interest rates. Builders throughout the District reported substantially higher costs of lumber, concrete, and asphalt. A builder in North Carolina also reported shortages of insulation, wallboard, cement, and plywood.

Fifth District commercial realtors reported a slight uptick in leasing activity in April and May. Contacts in Raleigh, N.C., Columbia, S.C., and Richmond, Va., observed small increases in leasing. "Things have improved, but not enough to really celebrate," noted a realtor in Cary, N.C. In comparison, leasing activity in the Washington, D.C., metropolitan area increased substantially in recent weeks and that market remained the District's busiest. By sector, retail leasing remained strong in all markets, while office and industrial leasing generally continued to be sluggish. Rents across all sectors were generally flat. Outside of the Washington, D.C., metro area, realtors reported relatively little new construction over the past two months.

Tourism
Tourist activity picked up in May despite gloomy weather in some areas during the Memorial Day weekend. Hotel managers in Virginia Beach, Va., and Myrtle Beach, S.C., reported that their bookings rose substantially in recent weeks. Special events also boosted District tourism. In Washington, D.C., the dedication of the National World War II Memorial drew large crowds from outside the region and hotels across the city reported 100 percent occupancy rates. In addition, a contact at a mountain resort said that the announcement of plans for expanded resort facilities had boosted timeshare sales there.

Temporary Employment
District temporary employment agencies generally reported stronger demand for workers in recent weeks, attributing the increase to an improved economic environment. Production and distribution center employees and administrative, financial, and customer service workers were widely sought. Agents expected the demand for temporary workers to remain brisk over the next few months. An agent in Raleigh, N.C., said that some companies were starting to reinvest in their businesses, which he expected would lead to stronger hiring in that area in coming months.

Agriculture
Sporadic rainfall across the District in recent weeks led to a wide variation in soil moisture levels and crop development. Unseasonably hot and dry weather in May depleted soil moisture levels in much of North Carolina, but rain in early June improved soil conditions. In that state, cotton, peanut, and soybean plantings were generally ahead of schedule. In Virginia, the corn crop exhibited heat stress in some areas in May. In Maryland, field conditions were generally good and the planting of corn and harvesting of green peas and strawberries were progressing ahead of schedule.

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Sixth District--Atlanta

Summary
According to business contacts, economic growth in the Sixth District remained robust in April and May. Merchants reported that sales were above year-ago levels and that inventories were balanced. Auto sales improved slightly. Residential housing sales and construction remained at high levels, and commercial real estate markets improved marginally. Factory activity was mixed, but truck and rail shipments strengthened. Reports from the hospitality and tourism industry were positive, as were most responses from the financial sector. The hiring picture continued to improve overall, especially for durable manufacturers and services, but weakness persisted in some nondurable manufacturing industries. Businesses and consumers noted continued escalating prices for fuel, building materials, and metals.

Consumer Spending
Reports from District retail contacts indicated continued strength in May. Most contacts reported that sales exceeded year-ago levels and met expectations. The strongest reports came from Florida retailers. Inventories were described as balanced. Women's apparel, children's apparel, jewelry, shoes, and home-related products continued to sell well in most parts of the District. Retailers anticipate that second-quarter sales will also exceed year-ago levels. District auto dealers reported that vehicle sales improved slightly in April but remained off on a year-to-date basis. Contacts from major regional auto auction centers reported that used car prices firmed for the first time in the last two years.

Real Estate
District single-family housing markets remained robust overall in May, although some softening was noted for both new and existing home sales. According to most Realtors, home sales were up slightly in May. Home prices continued to rise, with builders pointing to rising material costs. The outlook among contacts remained upbeat, with home sales and construction levels during the second quarter expected to surpass last year's strong levels.

Modest improvements continued to be noted in District commercial real estate markets, but construction remained at low levels. Rising steel costs and cement shortages challenged many developers. Improvements in District commercial real estate markets are expected through year-end, but construction is expected to remain at low levels.

Manufacturing
Manufacturing activity was mixed. Steel producers reported strong orders and increasing profits, but fabrication businesses were under pressure because of higher steel prices. Increased demand helped furniture producers; some automotive suppliers and producers continued to add jobs. The lumber and building products industry reported continuing strong orders and profits; for example, a manufacturer of roofing material was operating at capacity. The fabric portion of the textile industry continued to experience weak demand and poor pricing power, whereas activity in the carpet industry was healthy. The District's industrial chemical producers continued to pare payrolls, reportedly because of high energy costs and foreign competition.

Transportation
Regional truck and rail shipments continued to post above-average gains through the first quarter. District trucking contacts reported strong demand for freight but a shortage of drivers. First-quarter airborne shipments rose sharply for Atlanta and Miami airports.

Tourism and Business Travel
Reports from the District's tourism and hospitality industry remained positive. Spring tourism was characterized as "great" in South Florida , with booking numbers indicating continued strong activity during the summer. The weak dollar reportedly prompted more Europeans to visit South Florida as well as domestic visitors to go there instead of overseas. Traffic out of Orlando International Airport was reportedly back to pre-9/11 levels for the first time. Hotel operators in Nashville and Atlanta said that business travel was back, evidenced by the increasing number of groups holding meetings.

Financial
Responses from the financial sector were mostly upbeat. Reports from community banks throughout the District were positive. Asset quality and loan demand continued strong, and past dues remained low. Small business loan demand improved and one report noted that higher rates on term loans were not dampening demand for money. Demand for industrial and commercial loans also continued to improve modestly.

Employment and Prices
Hiring improved overall, especially among small businesses. Construction-related firms, some service firms, and manufacturers of autos and vehicle components added jobs. Layoffs continued at apparel producers and in the industrial chemical sector, however.

Reports again indicated rising input prices and increasing purchaser costs. High building material prices remained a problem for residential and commercial builders. Some businesses passed on higher fuel costs to customers. Florida hotels boosted room rates and restaurants raised prices.

Agriculture
Dry weather conditions prevailed through the end of May for growers in areas of Florida and Georgia , but heavy rains reduced fieldwork days in Louisiana and Mississippi.

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Seventh District--Chicago

Summary
The Seventh District economy expanded solidly in late April and May, due in part to a

stronger, broader-based advance in manufacturing. Consumer and business spending increased, and hiring picked up. Overall construction and real estate activity moved slightly higher, reflecting some improvement on the nonresidential side. Lending volumes were fairly flat. Contacts continued to express concerns over rising input costs, but retail price pressures remained largely subdued. Agricultural conditions in the District were mixed, as excess precipitation followed a quick start to the planting season.

Consumer spending
Consumer spending picked up modestly in late April and May. More retailers noted stronger sales growth than during our previous reporting period. Lower-priced goods, especially food and consumables, were again top sellers for many retailers. One national chain reported that strong demand for apparel and home furnishings boosted sales beyond its expectations. By contrast, another noted softening sales of big-ticket items, such as appliances and electronics. Merchants generally suggested that inventories were slightly lean relative to their sales expectations, and that margins had improved. Auto dealers indicated that light vehicle sales in the District picked up from April to May, though some said that more aggressive pricing was used to close deals. Light vehicle inventories were still high for some dealers, with one stating that his lots were "bursting at the seams." Parts and service sales remained solid. Tourism and travel was basically flat relative to a year ago.

Business spending
Business spending continued to strengthen as firms appeared more confident about their near-term investment and hiring plans than at any point so far this year. We continued to hear reports of strong replacement demand for capital equipment. In addition, some contacts said that capacity constraints have motivated them to boost capital spending. This was particularly true in the transportation sector. With the volume of goods shipments increasing across the country, more over-the-road trucking firms reported investing in tractors and trailers. Similarly, rail freight companies said they were purchasing boxcars and containers. On the hiring front, staffing services firms noted stronger new orders for temporary workers in much of the District, though Michigan appeared to be lagging. The pickup was broad-based across market segments--industrial (outside of autos), office/clerical, and professional/technical occupations. One large online job posting service reported that listings for open positions rose in April and May, and hiring plans at some firms had shifted from "hopeful anticipation" to "immediate need today." More small manufacturers reported adding permanent full-time employees. Most employers were having little difficulty finding adequately skilled workers, though there were isolated reports of shortages in trucking, specialized IT, and accounting professions.

Construction/real estate
Overall construction and real estate activity moved slightly higher in late April and May. Contacts suggested that home sales flattened out somewhat, but remained at high levels. Realtors and builders indicated that many "fence-sitters" had already jumped into the market earlier when mortgage interest rates began to rise. Some builders said that model traffic had slowed considerably and "festival of homes" events were disappointing. As a result, builders were applying for fewer permits. Contacts in some areas also reported that sales in the upper-priced ranges for both new and existing homes had softened again. In contrast, nonresidential activity appeared to pick up. Office showings and lease signings were up in a few metropolitan areas. On balance, net office space absorption was positive, though rents were flat. However, contacts said that office markets "still have a long way to go," and there was very little new development in the pipeline. Absorption of light industrial space was also said to be improving, and there appeared to be a modest increase in development. Retail development remained strong, and one contact expressed surprise at a recent pickup in the absorption of vacant big-box space.

Manufacturing
Contacts reported a stronger, broader-based advance in manufacturing activity in April and May. Several of the District's important industries--including gypsum wallboard, cement, steel, and heavy trucks--were said to be running at, or very near effective capacity. Strong worldwide demand, particularly from China , was reportedly limiting imports and contributing to domestic shortages of commodities such as cement and steel. Producers of steel indicated that orders were booked for the foreseeable future. In addition, a steel service center contact reported that his firm was on allocation for some products, and "deliveries were out as far" as he had ever seen them. Heavy trucks may soon be on allocation as well, according to one industry contact, as heavier shipping volumes led to a surge in truck demand. New orders for other heavy equipment (construction, agricultural, mining, etc.) were up substantially from a year ago with practically all of our industry contacts reporting improvement. Producers of office furniture noted a modest increase in orders, leading one firm to scrap previously announced layoff plans. Nationally, light vehicle demand was stronger than expected in May, which helped bring bloated inventories in the U.S. closer to desirable levels. However, auto manufacturers have not altered their production plans since the previous Beige Book reporting period. Automakers also said that record-high gasoline prices had not had a discernible negative impact on light truck sales. Small manufacturing firms were seeing higher production, new orders, and backlogs virtually "across the board," according to some industry sources; one producer of specialty machine tools said that demand was stronger than it had been in the last three years.

Banking/finance
Overall lending activity remained fairly flat. On the consumer side, refinancing tapered off considerably with higher mortgage interest rates. New originations were still relatively strong, with many homebuyers switching from fixed-rate to adjustable-rate mortgages. Margins continued to be squeezed as lenders competed for a smaller pool of potential mortgage borrowers. On balance, consumer credit quality continued to improve, and there were no changes reported in standards and terms for household loans. Business loan volumes appeared to edge up "incrementally," but were again relatively flat. One lender said that "commercial loan officers were pounding the pavement looking for deals," but weren't finding many. Contacts suggested that firms continued to use improved cash flow to meet their short-term liquidity needs, rather than borrowing. Business loan quality improved further in May, although some banks were reportedly lowering standards to secure deals in an increasingly competitive lending environment.

Prices/costs
In general, many more business contacts said that strong demand throughout the economy was enabling them to push prices up modestly, albeit from very low levels. Contacts continued to express concerns over rising input prices, but most believed that the big cost increases for inputs such as steel and energy were largely behind us. More firms reported success in pushing through at least part of higher input costs to their customers, though many still said that margins were being squeezed. Freight costs continued to rise as stronger economic activity put a strain on shipping capacity. At the retail level, merchants (with the exception of auto dealers) generally continued to pull back on discounting. There were no new reports of upward pressures on wages and other labor costs.

Agriculture
The agricultural situation was in greater-than-usual flux during the Beige Book reporting period. Almost all corn acres and a large portion of soybean acres had already been planted when heavy rains fell across most of the District. Corn and soybean planting in the District was ahead of the 5-year average, though soybean planting in Michigan and Wisconsin lagged. The emergence of corn and soybeans was well ahead of the 5-year average, except in the northern reaches of the District. The overabundance of moisture, however, delayed the end of planting and raised concerns about crop yields. Many drowned-out acres will be replanted to soybeans, but some acres will not be replanted. Land values continued to increase, in part due to tax-free exchanges and the lack of farmland for sale.

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Eighth District--St. Louis

Business conditions in the Eighth District continued to improve since our last survey, as reports of plant openings and expansions in manufacturing and services continued to increase. Retail and auto sales increased in April and May over year-earlier levels. Residential real estate activity picked up, while commercial real estate markets remained soft. Overall lending activity at a sample of District banks experienced little change over the past three months.

Consumer Spending
Contacts reported that retail sales in April and May were up by about 2 percent, on average, over year-earlier levels. In our survey, 44 percent of the retailers noted that sales levels met their expectations, 37 percent reported that sales were below what they had anticipated, and 11 percent reported sales above expectations. Summer seasonal and outdoor items, women's apparel and accessories, and home items were strong sellers, while specialty items and gift items were moving more slowly. About 67 percent of the retailers surveyed noted that inventories were at desired levels. Retailers appear generally optimistic about the summer months, with more than half of the contacts expecting sales to increase over 2003 levels.

Car dealers in the District reported that, compared with last year, sales in April and May were up by about 4 percent, on average. Nearly 60 percent of the car dealers surveyed noted that sales of used and low-end cars had increased, a change they attributed to an increase in consumer demand for smaller, more fuel-efficient cars in light of recently rising gasoline prices. About 32 percent of the contacts reported increased use of rebates, while 40 percent reported no change. Approximately 48 percent of contacts surveyed reported a decrease in the acceptance rates of finance applications, while 4 percent reported an increase in acceptance rates. Nearly 50 percent of the car dealers surveyed reported that their inventories were at desired levels, while 44 percent reported that their inventories were too high. A majority of the car dealers surveyed are cautiously optimistic about sales during the summer months.

Manufacturing and Other Business Activity
The Eighth District's manufacturing sector continues to show signs of strong improvements in many areas. Reports of plant openings, hiring, and relocations to the District have increased since our last report. Manufacturers in the metal products, transportation equipment, automotive parts, prefabricated buildings and home elements, food processing, packaging, recreational equipment and parts, and industrial equipment sectors reported stronger orders, plant expansions, and plant openings in part due to new product line introductions and increases in consumer demand. Despite strong growth in some areas, other District manufacturers reported layoffs and plant closings. Manufacturers in the paper materials, textile, tobacco, electrical equipment, energy, rubber, and printing sectors reported plant closings and layoffs due in part to company reorganization, the need to reduce costs, and foreign competition.

The District's services sector also shows signs of strong improvement in most areas. In particular, firms in the health care, tourism and entertainment, freight transport, financial and insurance services, farm equipment, home hardware, and clothing retail sectors reported openings and expansions. Despite the generally strong reports in the services sector, firms in the business solutions and food retail sectors reported closings and layoffs.

Real Estate and Construction
Home sales have picked up in the Eighth District. Year-to-date home sales rose in April in several cities. Memphis had a 3.8 percent increase in April year-to-date sales compared with 2003. Louisville had a similar increase of 3.7 percent compared with the previous year, and the greater St. Louis metropolitan area had an increase of 6.5 percent over the same period. Residential construction remains robust throughout the District. April year-to-date permits for single-family residences were up in most metropolitan areas. In St. Louis, for example, April year-to-date permits increased by 8.7 percent. Contacts reported a high volume of construction near Paducah, Kentucky.

Commercial real estate markets remain soft throughout the District. The first quarter's industrial vacancy rate in St. Louis fell to 6.8 percent from 7.3 percent at the end of 2003, while Memphis continues to experience a vacancy rate of about 16 percent. Office vacancy rates are also high. The vacancy rate for the greater St. Louis area remained stable at 17.1 percent in the first quarter, and in Memphis the vacancy rate increased slightly to 15.9 percent. Commercial construction appears to be strong in most of the Eighth District. Contacts in Little Rock, Arkansas, are optimistic about the near future, and construction is improving in Texarkana and Pine Bluff, Arkansas. Central and south central Kentucky continue to be bright spots, with a growing number of schools, office buildings, and churches being built. Construction is very active in Jackson, Tennessee, and has improved over the past month in rural west Tennessee.

Banking and Finance
A recent survey of senior loan officers at a sample of District banks indicated little change in overall lending activity in the past three months. During this period, credit standards and demand for commercial and industrial loans remained unchanged for both large and small firms. Meanwhile, both the credit standards and the demand for residential mortgage loans, commercial real estate loans, credit cards, and other consumer loans were generally unchanged.

Agriculture and Natural Resources
Recent heavy rains, and subsequent damage from flooding and pond formation, throughout the District have necessitated the replanting of some corn and soybean fields. The rains, however, have helped improve soil moisture levels. Despite weather damage in certain areas, the majority of the winter wheat crop is in good or excellent condition and will be ready for harvest within a few weeks in some places. Nearly all of the intended corn, cotton, and rice crops have been planted. Except in Kentucky, where planting is only slightly behind its normal pace, farmers in every District state have planted at least half of their soybean fields and more than two-thirds of the sorghum crop. A majority of the District's other crops are in good or excellent condition, as are pastures and livestock.

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Ninth District--Minneapolis

From mid-April through early June the economy in the Ninth District grew steadily. Growth was noted in real estate, construction, manufacturing, agriculture, mining, energy and consumer spending. District employment relative to last year picked up considerably, while wage increases were moderate. Some signs of price acceleration were noted, including significant increases in tuition, and in a number of commodities and manufacturing and construction inputs.

Construction and Real Estate
Commercial construction activity heading into summer showed some signs of recovery. Most builders surveyed claimed they were seeing steady to increasing business since last year; however, one contractor in western South Dakota reported reduced activity. Several builders cautioned that while the value of business was up, much of it could be attributed to price increases in building materials and fuel. In contrast, the value of contracts awarded for large construction projects in Minnesota and the Dakotas decreased 6 percent for the three-month period ending in April compared with a year ago.

Homebuilding and residential real estate activity were solid. Housing units authorized in District states increased 6 percent for the three-month period ending in April compared with a year ago. The number of signed purchase agreements in the Minneapolis-St. Paul area increased almost 12 percent in April compared with last year. A representative of a realtors association in Minneapolis-St. Paul said that homebuying activity was strong, as well as growth in the number of listings.

Consumer Spending and Tourism
Retail sales grew moderately. A major Minneapolis-based retailer reported that same-store sales during May were up about 5 percent compared with a year ago. A North Dakota mall manager reported that sales were up 6 percent in April and 2 percent each of the first two weeks in May. In the Minneapolis area, a mall manager noted that April was a strong month in both traffic and sales, but May traffic was down slightly from last year. May sales were up 1 percent at another mall in the Minneapolis area, but increases were larger earlier in the year; recent summer apparel sales were slow due to the cool weather.

A representative of an auto dealers association in Minnesota said that sales in May were strong compared with a year ago. In addition, high gasoline prices were not impeding sales of SUVs. In South Dakota, a representative of an auto dealers association reported strong sales in April compared with a month earlier.

Tourism activity was somewhat slowed during Memorial Day weekend due to cool and rainy weather; however, prospects for summer were optimistic. In northwestern Wisconsin, a chamber of commerce official said that retailers that rely on warm weather have seen declining sales, but restaurant traffic was up. According to a survey conducted by the Minnesota Office of Tourism, only a few business owners expect decreases in activity due to higher gas prices, and others noticed that travelers were tending to stay closer to home. Over 45 percent of respondents expect higher revenue during the summer months; 23 percent expect decreases. A tourism official in Montana said that summer reservations were in line with last year's numbers--which were strong compared with previous years.

Manufacturing
Manufacturing activity increased. A May survey of purchasing managers by Creighton University (Omaha, Neb.) indicated strong growth in manufacturing activity in the Dakotas and Minnesota. Intentions to build several meat processing plants were announced for Minnesota and South Dakota. A maker of watercraft plans to build a plant in Minnesota. An Advisory Council member who owns a manufacturing facility in the Upper Peninsula reported strong sales growth.

Energy and Mining
Activity in the energy and mining sectors remained robust. Late May District oil and natural gas exploration and production amounts increased slightly from mid-April levels. Meanwhile, prices for most major District mining commodities remained strong. District iron ore mines continued to produce at capacity, and the shipping season is in full swing with Great Lakes water levels and traffic flow up from the low volumes of 2003. The operating mines in Montana produced at near capacity, and some mine workers received profit-sharing checks for the first time in nearly five years.

Agriculture
Agricultural conditions were positive. Prices remained robust for most District agricultural commodities. The U.S. Department of Agriculture reported that May prices for livestock, hogs, and broilers increased from April. The USDA expected May milk prices in Wisconsin to increase to a record $21.50 per hundred pounds. Meanwhile, corn and soybean prices dropped slightly but remained at high levels. Crop progress was ahead of last year and the five-year average for most District crops. Spring rainfall was bountiful across much of the District and relieved drought conditions; however, too much rain saturated some fields and may require some replanting in the eastern portions of the District. Continued drought dried up hopes in the western part of Montana.

Employment, Wages, and Prices
Hiring activity increased since the last report. Nonfarm employment in District states increased 1.3 percent in April compared with the same month a year ago, the largest year-over-year increase since January 2001. Recent announcements to increase employment levels were also noted. A new turkey processing plant planned for South Dakota could employ as many as 1,000 workers. In Minnesota, a defense contractor plans to add 200 jobs, and a credit card processor will expand, adding 50 employees. A new power plant in the Upper Peninsula is expected to create 26 new jobs. Representatives of technology industries in the Minneapolis-St. Paul area recently indicated that revenue and hiring plans were rising somewhat. A Montana bank director commented that quality unskilled workers were in short supply. Initial claims for unemployment insurance decreased 30 percent in Minnesota during April compared with a year ago.

In contrast, a desk assembly plant in northwestern Wisconsin recently announced plans to close, resulting in 51 lost jobs. A major disk-drive manufacturer that employs about 3,500 in Minnesota will trim its total workforce by 7 percent.

Wage increases were modest. For example, farm operators in Minnesota, Wisconsin, and Michigan paid hired workers 2 percent more per hour in April compared with a year ago.

Some signs of price acceleration were noted. Tuition at the University of Minnesota is slated to increase 14 percent for the coming school year. Gasoline prices in Minnesota at the end of May were up 38 percent compared with a year earlier. A Minnesota meat company recently raised prices about 4 percent to 6 percent on packaged food items. A bank director noted that trucking fuel surcharges were up, and fertilizer prices were at an all time high. Drywall, lumber and cement have all gone up significantly, with many builders particularly concerned about the price of steel. Oriented strandboard prices increased over 200 percent from a year ago.

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Tenth District--Kansas City

The Tenth District economy continued to expand in late April and May. Retail sales rose moderately, factory activity increased further, and labor markets showed additional improvement. Also, housing and energy activity continued to rise from high levels, and agricultural conditions were generally solid. Commercial real estate, on the other hand, remained relatively weak. Wage pressures were still muted and retail price increases were modest, but many manufacturers were raising their output prices.

Consumer Spending
Consumer spending in the district increased moderately in late April and May. Retailers generally reported steady sales gains since the previous survey, with sales solidly above year-ago levels at most stores. Among product categories, sales were strongest for women's and children's apparel. Inventory levels were generally reported as satisfactory, but some stores were planning to expand stock levels heading forward. Nearly all managers anticipate solid increases in sales in coming months. Motor vehicle sales in the district were flat to slightly higher in late April and May compared with previous months, and the modest improvement pushed sales above year-ago levels in most places. Dealers reported truck and SUV sales remained strong despite increases in gasoline prices, although some did note a recent shift in demand from large SUVs to smaller SUVs. Most dealers were very optimistic about future sales, although a few dealers expressed concern about increasing rejections of loan applications due to applicants' high debt burdens. Travel and tourism activity improved in most areas in late April and May. Airport traffic was up considerably throughout the district, due in part to a rise in business travel, and some airports anticipate record passenger traffic this summer. Hotel occupancy rates were also up modestly in many areas, including some resort areas which had suffered from poor snowfall in late winter. Tourism businesses reported little impact from rising gasoline prices and solid advance summer bookings in most areas.

Manufacturing
District manufacturing activity continued to expand in late April and May. Manufacturers reported further increases in production and shipments, and a sizable number of firms said they had added workers since the previous survey. Most plant managers also said recent increases in activity had pushed their capacity utilization rates up to or beyond pre-recession levels. Capital expenditures were up sharply at many firms and were at or above year-ago levels at nearly all firms. A growing number of firms were also expanding their inventories of raw materials. Many firms, however, were having difficulties obtaining steel and selected other materials, and supplier delivery times were up considerably from earlier in the year, particularly for materials transported by train. Heading forward, firms remain quite optimistic about future factory activity and plan continued increases in employment and capital spending despite expectations for some leveling off in the rate of increase of new orders.

Real Estate and Construction
Residential real estate activity continued to increase in late April and May, while commercial real estate remained generally weak. Single-family housing starts improved further in most cities and were above year-ago levels throughout the district. According to builders, demand for less expensive homes was stronger than for higher-end homes since the previous survey. Builders generally anticipate continued steady improvement in home construction through the summer, although some concerns remained about the impacts of rising materials prices and mortgage rates. Residential realtors reported solid increases in home sales in nearly all district cities, with sales much higher than a year earlier in many areas. Several realtors noted that the recent rise in mortgage rates had encouraged some reticent buyers to close on home purchases. Looking ahead, realtors expect home sales to level off slightly and home prices to continue to post modest gains. Mortgage lenders generally reported little change in mortgage demand compared with the previous survey. However, demand was down moderately from year-ago levels in most areas due to lower refinancings. Lenders expect mortgage demand to remain steady through the summer with a continued shift from refinancings towards home purchase loans. Commercial real estate activity was still generally weak. Vacancy rates were largely unchanged compared with the previous survey, and a considerable amount of excess space persists in most cities. On the positive side, vacancies are expected to edge down and prices for office space are expected to increase slightly over the rest of the year.

Banking
Bankers report that loans increased and deposits held steady since the last survey, raising loan-deposit ratios somewhat. Demand edged up for all loan categories except consumer loans, which were unchanged from the previous survey. On the deposit side, all types of accounts held steady. Almost all respondent banks left their prime lending rates unchanged, but a few banks raised their consumer lending rates slightly. Lending standards were generally unchanged.

Energy
District energy activity continued to rise modestly in late April and May. The count of active oil and gas drilling rigs in the region was up slightly from the previous survey and was still well above year-ago levels. Many firms noted that expansion was being limited by rising prices of equipment and materials, shortages of labor, and a lack of permits in some areas. Even so, oil and gas contacts generally foresee a further increase in drilling heading forward, given their expectations that energy prices will remain high.

Agriculture
Agricultural conditions in the district generally remained solid. Strong grain and livestock prices increased farm revenues and contributed to higher loan repayment rates. Some crop producers reportedly compensated for high energy costs by converting irrigation systems from natural gas to other energy sources and by shifting to no-till production. In the livestock market, herd expansion has been constrained by low cattle supplies and drought conditions. The drought has also trimmed the winter wheat crop in portions of the district, although recent heavy rain improved conditions somewhat.

Wages and Prices
Wage pressures remained muted and retail prices were up only modestly in late April and May, but manufacturers were increasingly raising their output prices. Labor markets continued to improve, with more hiring announcements than layoff announcements by district firms since the previous survey. Also, some labor shortages were reported in the manufacturing, trucking, energy, and health care industries. A few manufacturing and energy contacts noted particular difficulties adding qualified entry-level employees. Most firms, however, continued to have few problems hiring workers and were not finding it necessary to raise wages more than normal. Retailers generally reported flat selling prices, although some stores raised prices modestly on items made from steel, wood, or petroleum-based products. Retailers generally expect prices to be flat to slightly higher heading forward. Many trucking and rail firms in the district have increased rates in recent months due to rising fuel costs and increased demand. Builders continued to report rising prices for lumber, sheetrock, and steel products, and said that prices for cement have also begun to rise recently. Further increases in building materials prices are expected. Nearly all manufacturers reported continued increases in raw materials prices, and about half of the factories contacted had raised their output prices from a year ago. Manufacturing input and output prices are expected to continue rising in coming months, but the rate of increase is expected to begin tapering off in the second half of the year.

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Eleventh District--Dallas

Eleventh District economic activity continued to expand from mid-April to early June. Manufacturing activity was up, and contacts were generally more optimistic about the outlook for the sector. Demand for business services is increasing but remains slower than contacts expected. Retail sales were mixed. Construction and real estate markets strengthened, while financial services activity continued to improve. Energy activity remains relatively strong but has responded little to the recent spike in prices. Agricultural conditions continue to be favorable.

After over two years of contacts expressing caution about the economic outlook because of geopolitical fears, these concerns were notably muted in this report. One retailer explained that consumer spending was not affected by the terrorist acts in Spain, suggesting that these worries have finally receded to a more normal level. Concerns are now focused on the high cost of energy and potential governmental changes, such as an increase in the minimum wage and problems with school finance in Texas. Some contacts noted concerns that the Texas Legislature might raise sales or other taxes hurting business.

Prices
Energy prices were up strongly, and many contacts expressed concerns about the rising cost of fuel and gasoline. Strong international demand and terrorism fears led to a sharp increase in crude oil and gasoline prices. Contacts say it is estimated that $5 to $15 of the price of crude is linked to fear of supplies being interrupted by terror attacks. Strong demand also pushed up natural gas prices.

Increasingly, there are reports that rising energy costs are pushing up selling prices for manufactured products. Prices are up for petrochemicals, plastics, steel, aluminum, lumber, paper, liner board, cement, brick, tile, glass, ceramics, corn, rice, wheat, cheese, milk, and ice cream. Retailers said downward pressures on selling prices have abated. Although list prices were mostly unchanged, retailers say they are taking smaller mark downs, so consumers are paying higher prices for many products. Stiff competition is keeping downward pressure on selling prices for apparel manufacturers and telecommunications services.

Labor Market
The labor market remains relatively weak but is strengthening. There are scattered reports of increased hiring. There was little pressure on wages but contacts remain very concerned about the high cost of benefits, such as for workers compensation and medical insurance.

Manufacturing
Demand continued to pick up for many products, including food, apparel, metals, lumber, paper, and packaging. Manufacturers of cement, brick, tile, and glass reported that demand was up slightly from a year ago.

High-tech manufacturers said sales growth continued at the good pace recorded at the last survey. Orders for semiconductors have been volatile, according to manufacturers, because buyers, particularly from China, often order large quantities to get price discounts and then refrain from ordering for several months until inventories are pared down. Demand was strong for products such as hand-held devices and, in particular, two-way radios.

There has been slight improvement in the demand for telecommunications services. These firms say they continue to find ways to cut costs, either through their hiring practices or by outsourcing. Demand is unchanged for telecommunications manufacturers.

Strong demand for gasoline is helping refiners earn record profit margins. Gasoline demand is estimated to be 2 percent to 4 percent higher than a year ago. Refiners are operating at very high levels to supply gasoline and are paying premiums to purchase gasoline-rich sweet crude to improve the gasoline output relative to other products. Still, gasoline inventories remain at the bottom of the five-year average. Although imports have been strong, refiners say they are having difficulty meeting the new low-sulfur requirements that went into effect nationwide in January. They are also having trouble supplying "boutique" fuels that have tougher environmental requirements and are required in the northeast and California. The annual spring change-out of high- for low-volatile gasoline is complicating the inventory problem, according to contacts. The low-sulfur and boutique requirements pose a particular problem because they cannot be replaced easily by imports.

Demand for petrochemical products is strong, particularly for ethylene. Demand for polyethylene has also improved, following weak demand during the spring. Export demand for ethylene and polyethylene is strong, with most going to Asia.

Services
Business service contacts report that activity is increasing but remains slower than expected. Law firms report an increase in the number of billable hours, primarily due to more transactional work, such as mergers, acquisitions, capital/equity financing, and IPOs. There has been a slowing in litigation activity. Demand for temporary workers has increased steadily, although activity is still a little slower than expected. New business is primarily for light industrial, manufacturing, distribution centers, clerical, and customer service employees.

Demand for rail shipments remains strong, which one contact attributed partially to higher fuel prices leading shippers to switch from trucking to rail because railroads are more fuel efficient. While the demand for air travel has increased recently, airlines continue to report that the industry is having trouble taking off. Increases in industry capacity and fuel costs are squeezing profits. Relatively newer, low-cost airlines without union contracts are in the best shape.

Retail Sales
Sales continued to expand for most retailers but the strength of reports were mixed. Some contacts said sales growth remained at or above expectations, while others said sales had softened slightly or were slower than expected. Sales of apparel were particularly strong. Most national retailers said Texas sales continue to be slower than the rest of the nation. Automobile sales remained flat, and dealers say there are fewer potential customers visiting showrooms. Inventories are higher than desired for the current level of business.

Construction and Real Estate
Existing home sales have picked up over the past six weeks, which contacts attribute to customers rushing to beat rising mortgage rates. There has been little change in the pace of new home sales, but new home construction is increasing rapidly, and inventories are rising. New home prices are up, according to builders who say they have been increasingly able to pass along higher prices for lumber, fuel, and concrete. Demand for apartments has edged up, according to contacts, but the market remains overbuilt and there are a large number of units under construction.

Contacts are generally optimistic that commercial real estate markets are recovering. Office leasing activity has picked up, and contacts say companies are not only renewing contracts but are expanding. Office rents have stabilized, and there are fewer concessions. Investor activity in the Dallas market remains strong. Industrial demand has also picked up some over the past six weeks.

Financial Services
Loan demand is picking up, but remains slower than desired. Deposits are unchanged or lower, and contacts say money is moving back into stock markets. Several banks said they are searching for deposits to fund loan growth. There are a few de novo banks starting. Competitive pressures are keeping loan pricing down, especially in the major metros.

Energy
There was little change in drilling activity or the demand for oil services, despite the recent increases in energy prices. Producers say they will remain on a measured exploration plan regardless of market conditions, because in the past, they have made mistakes throwing money after projects based on short-run market developments. There is excess capacity in the industry in seismic and offshore equipment. Land rigs are fully utilized.

Domestic drilling remains at a high number of rigs working--500 in Texas. However, they are mostly land-based rigs seeking shallow natural gas for a quick return. Offshore activity remains weak. Lucrative work in the Gulf of Mexico picked up slightly, only to fall back to levels near the trough of the last drilling downturn in 2001. International drilling activity continues to increase slowly, rising to a 10-year high in April.

Agriculture
Plentiful spring rains have resulted in the most favorable moisture levels reported in a number of years. Planting season is progressing well, and most planted crops are thriving except for a few isolated incidents of crop failures in the Brazos River Area. Beef demand remained strong, pushing up feeder cattle prices. The U.S. and Canada reopened trade of cattle 30 months or younger.

U.S. agricultural exports picked up, which contacts attribute to the declining dollar. There were concerns, however, that the preliminary World Trade Organization ruling against cotton subsidies would negatively affect farmland values, cotton producers, lenders and possibly subsidies for other crops.

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Twelfth District--San Francisco

Summary
Reports from contacts indicate that economic activity expanded at a solid pace in most areas of the District from mid-April through the beginning of June. Contacts noted further increases in the prices of gasoline and other commodities, but the pace of overall price inflation remained modest. Hiring activity picked up in many areas, but labor generally was in ample supply and upward pressure on wages and salaries was limited. Sales of automobiles, retail merchandise, and most types of services were quite strong, and contacts reported robust demand in the manufacturing sector. Sales of District agricultural and resource products were solid, especially for exported products. Activity remained vigorous in residential real estate markets, and further improvement was evident on the nonresidential side. Banks saw solid loan demand overall, with increases in commercial lending noted in some areas.

Prices and Wages
District contacts reported that the pace of price increases in the survey period was similar to the slightly increased rate established in the previous period. Rising prices for energy products and some raw materials, notably steel and lumber, raised transportation costs in general and production costs in selected industries. More generally, there were scattered reports of increased pricing power for retailers and service providers. The overall pace of price inflation remained modest, however, and most contacts expect little or no pickup in the pace of price increases over the balance of the year.

Ample labor availability kept wage and salary pressures limited throughout the District. Hiring activity picked up in many areas, with contacts in the construction, banking, manufacturing, retail, and services sectors reporting increases. Most new hires were for full-time, permanent positions, although temporary workers remained in demand, particularly in the retail and services sectors. Rising health insurance costs reportedly were the most significant source of increased compensation costs, even though many employers have been passing an increasing share of health costs on to their workers.

Retail Trade and Services
District contacts reported stronger retail sales than in the previous survey period. Automobile sales remained at high levels, sustained in part by generous financing incentives. Inventories of domestic autos remained high, however, and sales of sports utility vehicles and trucks slowed in the second half of the survey period, reportedly due in part to consumer concerns about rising fuel prices. A respondent from a major department store chain noted improved sales, and retail prices generally were stable, with less price discounting evident than in past survey periods.

Service providers saw solid demand throughout the District. Media and health-care service providers reported further improvements in sales, and one provider of high-tech services noted double-digit sales increases over last year. District travel and tourist activity strengthened further. Hawaii 's tourist traffic rose smartly, due to solid gains in domestic tourism and a sharp increase in visitors from Japan. However, respondents in some areas expressed concern that higher fuel prices could damp leisure travel this summer, especially to destinations that rely primarily on visits by automobile.

Manufacturing
District manufacturers saw further solid increases in production and sales across a wide range of products. Demand for semiconductors was very strong, keeping inventories low and further raising capacity utilization. Some makers of machine tools faced rising order backlogs due to rapid demand growth. Strong housing starts and rising demand for packaging materials fueled robust sales and firmer prices for wood panels, pulp, and paper. District apparel makers saw rising orders and inventories remained lean. The main exception to strong conditions was in the commercial aircraft sector, where orders remained somewhat weak and employment counts fell a bit further. More generally, rising demand has prompted some manufacturers to increase hiring, and a machine tool manufacturer in the Pacific Northwest noted growing difficulties finding qualified labor for available openings.

Agriculture and Resource-related Industries
District providers of agricultural and resource products reported generally solid demand. Sales were strong for beef cattle and fruits, nuts, and other types of produce; export growth was especially robust, boosted in part by continued weakness in the dollar relative to key foreign currencies. Prices increased sharply for dairy products; in contrast, potatoes were in abundant supply, and prices fell. Contacts in the resource sector noted rising demand for crude oil and natural gas; however, capacity expansion was constrained somewhat by delays in obtaining raw materials, notably steel.

Real Estate and Construction
Demand was vigorous in residential real estate markets, and conditions improved a bit further on the nonresidential side. Sales of new and existing homes were rapid throughout the District, achieving a near-record pace in Hawaii and Southern California, despite rising interest rates for home mortgages. Strong demand, particularly for less-expensive homes, has kept prices rising at a solid clip in most District markets, especially Southern California. On the commercial side, demand for office space improved a bit further in some areas, although rental rates remained largely flat. Respondents reported that shortages of some building materials, such as steel and cement, increased construction costs and caused construction delays in some cases.

Financial Institutions
District banking contacts reported strong loan demand and good credit quality. Commercial lending rose noticeably in several areas, and respondents noted healthy or improved credit quality. Demand for mortgages to finance home purchases remained strong, but refinancing activity plummeted in response to rising interest rates.

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