

For use at 2:00 p.m., E.S.T.  
Wednesday  
March 8, 2000

Summary of Commentary on \_\_\_\_\_

# **Current Economic Conditions**

by Federal Reserve District

February 2000

SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS  
BY FEDERAL RESERVE DISTRICTS

February 2000

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## SUMMARY\*

Reports from the twelve Federal Reserve Districts indicated appreciable expansion of economic activity during late January and February. The majority of districts reported strong growth during the survey period, with the remaining reports pointing to moderate growth or continued high levels of activity. Retail sales expanded significantly over their year-earlier levels. Gains in manufacturing output were widespread. Providers of services to businesses and consumers continued to expand output and employment substantially. Real estate market activity and construction were at high levels, although slight cooling was evident in some areas. Conditions in the agricultural and resource extraction sectors were mixed. Demand for bank loans generally was strong, but several districts reported slower activity in some loan categories, especially consumer loans and residential mortgages.

Constraints on the availability of labor and other production inputs were apparent in many areas. Most districts reported tight supplies and upward wage pressure for various types of labor, both skilled and entry level. Despite faster wage growth for some workers, increases in the prices of final goods and services were limited overall, although the prices of transportation services and some industrial commodities rose noticeably.

### **Consumer Spending**

Retail sales were strong in most areas and generally met or exceeded retailers' expectations for the period. Compared to a year earlier, growth in retail sales was in the upper

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\* Prepared at the Federal Reserve Bank of San Francisco based on information collected before February 29, 2000. This document summarizes comments received from businesses and other contacts outside the Federal Reserve System and is not a commentary on the views of Federal Reserve officials.

single-digit range in Boston, the mid-single digit range in Chicago, and 3 to 7 percent in New York. By product line, consumer electronics, appliances, and home furnishings posted the strongest sales increases. Further advances in e-commerce sales were reported in a few districts, although Kansas City noted that online sellers gained business at the expense of retailers in rural areas. Demand for automobiles and light trucks was solid on net; sales mostly were at or above high levels from a year earlier, with reports of double-digit gains in the Minneapolis District. In contrast, several districts noted sluggish sales of apparel. Inventories generally were deemed appropriate for the prevailing pace of sales, although slow sales contributed to a buildup of apparel inventories in San Francisco and winter merchandise inventories in New York.

### **Manufacturing**

Most districts reported a pickup in manufacturing activity in January and February. The gains were moderate in general, although Richmond's report indicated considerable strengthening. Cleveland noted strong growth in demand for industrial machinery. Sales of semiconductors and related high-tech equipment were strong in Dallas and San Francisco, and earlier tight supplies of semiconductors and flat-panel display monitors have eased. Demand for a variety of other manufactured products grew substantially, including metal products, electronics, furniture, chemicals, paper, and food. Demand for steel was especially strong, largely for use in the manufacture of motor vehicles and other consumer durable goods. Among less upbeat indicators, Boston, Atlanta, and San Francisco noted cutbacks or ongoing weakness in aerospace manufacturing, and Chicago reported that the market for construction and agricultural equipment remained soft. In addition, Dallas reported that refineries in that district

are being squeezed by high prices of crude oil and have reduced output; reports from that district also indicate that gasoline inventories are low heading into the spring and summer driving seasons.

### **Nonfinancial Services**

Reports from the Boston, New York, Richmond, Dallas, and San Francisco Districts indicated that activity of firms providing nonfinancial services to businesses and consumers grew briskly during the survey period. Temporary employment agencies were very busy, with Boston reporting revenue growth of 25 percent from a year earlier for these firms. Computer services firms expanded rapidly in several districts, with newly created internet firms reportedly spending large sums on advertising campaigns in the San Francisco District. Demand for transportation services was strong, but availability of trucking services was constrained in some areas by labor shortages.

### **Real Estate and Construction**

Construction activity and demand for residential and nonresidential real estate remained at high levels, although cooling was evident in some markets. Demand for commercial space was strong in most areas, with low vacancy rates and rising rents even in areas where substantial new space has come on line. Reports from the Minneapolis District indicated that commercial construction values were up more than 20 percent in recent months compared with a year earlier. In contrast, Dallas reported a sharp increase in office subleasing and an ongoing decline in lease rates in that city; Atlanta noted slower nonresidential construction activity; and San Francisco reported that nonresidential markets have softened somewhat in two inland states in that district.

Residential construction activity and sales of new homes remained strong in many areas, although several reports cited evidence of slowing compared with 1999. Recent levels of construction and sales activity were near historical highs in the St. Louis and Minneapolis Districts, and they also have remained high in California, where home prices have been rising rapidly. However, signs of cooling in residential real estate markets have emerged in the Atlanta and Kansas City Districts and in several states in the San Francisco District.

### **Agriculture and Natural Resources**

Agricultural producers faced mixed conditions overall, with solid demand for meat products offset by drought conditions and poor crop yields in some areas. San Francisco noted rising demand for beef, and Chicago reported that hog farmers benefited from a substantial increase in hog prices during the past year. By contrast, drought conditions have hit Texas farmers hard, producing poor conditions for wheat and oat crops and necessitating costly supplemental feeding and herd reduction among livestock suppliers. Dry weather also has harmed the winter wheat crop in the Kansas City District and is a concern for cattle ranchers in Arizona.

Despite the recent sharp increase in the price of crude oil, conditions in the resource extraction industry were mixed. Oil drilling and extraction activity increased in several districts, but they were “lackluster” in Dallas, where companies have been choosing to pay down debt rather than risk expansion. In Minneapolis, mining of iron ore picked up further in response to strong demand, but gold mining remained weak.

**Financial Services and Credit**

Demand for bank loans was solid overall, although several districts reported softening in some categories. Lending activity was strong and expanded in most or all loan categories in Richmond, Chicago, and San Francisco. However, Cleveland reported declining demand for consumer and commercial loans, Kansas City noted that slower real estate loan activity had held total loans down, and New York, Philadelphia, St. Louis, and Dallas indicated that consumer and residential mortgage lending has slowed. Several districts noted that a relative scarcity of deposits has kept margins thin and has spurred search for alternative sources of funds; however, no district reported liquidity problems. Credit quality and lending standards were stable in general, although New York and Kansas City reported tighter standards for some banks.

**Employment, Wages, and Prices**

Labor markets were very tight in most areas, and wage pressures increased for some worker groups, although most reports suggested moderate wage gains on net. Reports of recruitment obstacles were widespread, and some employers responded by recruiting among nontraditional worker groups (for example, senior citizens and teens), relying on increased overtime, and emphasizing employment perquisites and bonuses rather than increasing base wages. Very tight market conditions were reported for nurses in St. Louis and Minneapolis, restaurant and retail workers in Kansas City, and computer-savvy workers in many districts. Chicago reported a sharp increase in truckers' wages, and San Francisco and New York noted shortages and high turnover among truck drivers. In terms of general year-over-year changes, wage gains were reported to be 3 to 5 percent in St. Louis and 2 to 4 percent in Minneapolis.



Kansas City reported that wage pressures have eased compared to the latter half of 1999. However, New York reported wage increases of 10 to 15 percent in jobs being filled by year 2000 college graduates recruited through employment agencies there, and Philadelphia reported faster wage gains overall.

Prices of some industrial commodities rose noticeably, especially for energy and petroleum-related products. Rising wages and fuel costs have raised prices and reduced profit margins for providers of transportation services, especially trucking. Other commodity inputs and raw materials with noticeable price increases included steel, primary metals, building materials, and computer memory chips in the industrial sector and chemicals and fertilizers in the agricultural sector. However, increases in the prices of final goods and services reportedly were limited overall.

## FIRST DISTRICT-BOSTON

Economic activity continues to expand in the First District. Retailers report strong sales growth and little price inflation. Most manufacturers are also seeing their business grow and indicate they are not raising prices. Labor markets remain tight. Most companies say base wages are rising at a 3 to 5 percent pace, although increasing numbers say they are raising wages more than this. In addition, temp firms report wages are up 5 to 10 percent from a year earlier. Firms continue to implement technologies or strategies that economize on labor and other inputs.

Retail

Most retail contacts report sales growth from year-earlier in the upper single-digit range for the December through mid-February period, at or slightly above expectations. Respondents in all sectors characterize their results as strong.

Permanent employment is said to be holding steady. Most retailers indicate that base wages are increasing at a 3 to 5 percent rate, although overall compensation is increasing faster because of performance-based incentives. However, contacts in faster-growing sectors are raising wages at a 5 to 10 percent pace in order to attract scarce labor. Retailers continue to report little evidence of inflation except in the fast-growing tourist sector. Contacts say that profit margins are increasing slightly as technological improvements yield cost efficiencies.

Retailers plan some modest capital expansions over the next six months; these expansion plans have changed little over the past year. Most contacts say that the economy is currently very strong and they are optimistic concerning sales growth prospects for the first half of 2000. However, looking toward the second half of the year, they expect to see a moderation in the rate of growth in consumer spending, reflecting the braking action of interest rate hikes and oil price increases.

Manufacturing and Related Services

Most First District manufacturing contacts report that recent business is up relative to a year earlier, although typically the gains are modest. Makers of building equipment and furnishings report

solid activity. Aerospace manufacturers continue to experience weakness but are beginning to see some positive signs for future business. Consumer goods manufacturers are experiencing good post-Christmas orders, although in some cases they say that ongoing inventory reduction efforts on the part of retailers are holding down new business.

Manufacturers cite rising costs for oil and gasoline, paper, copper, and furniture-grade lumber but reductions for electronic components. Most selling prices remain flat, and many contacts cite increased operating efficiencies or improved cost management techniques as being helpful in avoiding the need to raise prices. However, prices reportedly are rising somewhat for paper goods, consumer products, and industrial machinery. Prices of aircraft equipment are falling.

One-third of the respondents are reducing their head counts substantially as part of restructuring efforts. Employment changes at most other companies are fairly small. The majority of respondents indicate that average pay raises remain in the range of 3 to 5 percent, but a growing fraction report higher increases. Contacts indicate that tight labor markets have raised workloads for existing employees and increased the need to reward key personnel. Finance, accounting, information technology, research and development, and sales and service openings reportedly are the hardest to fill.

All contacts expect business either to be good or to show improvement this year. However, many point to at least some degree of uncertainty arising from their own restructuring efforts or those of competitors or customers.

### Temporary Employment

Temporary employment firms in the First District continue to expand, with overall revenues growing an average of 25 percent from a year earlier. As before, contacts report strong demand for information technology workers, especially those associated with the Internet. Wages are generally 5 to 10 percent higher than a year earlier, and these increases are in line with billing rates. E-business professionals and web developers are witnessing even greater wage growth because of high demand for their skill sets. In response to tight labor markets, many clients are increasingly using staffing firms to fill

their permanent hire needs. Outlooks are positive, although contacts say most of their clients are slightly concerned about future stock market performance.

### Commercial Real Estate

The commercial real estate market in New England has not changed much during the past quarter. The Boston office market continues its strong course, and contacts describe it as the “hottest” market in the country. Rents continue to rise. Vacancy rates for prime downtown office space are extremely low. Lack of space downtown has induced some firms to move to the suburbs, raising demand for office space in the 128/495 corridor. Rental rates in the suburban office market have increased as a result. Retail and multifamily markets are also very robust, with vacancy rates below 4 percent in both. Contacts do not expect any major changes in the Boston market.

The rest of New England is mixed. Hartford has seen some recovery, but its office vacancy rate is still one of the highest in the country, at around 20 percent. The retail and industrial sectors in Hartford have vacancy rates of 7.5 and 14 percent, respectively, also worse than the national averages. Rhode Island has experienced some restructuring in manufacturing and contacts anticipate an increase in industrial vacancy rates there. The office market in Rhode Island is doing well, however.

### Insurance

Continued restructuring in the insurance industry is resulting in employment reductions at some companies as redundant positions are eliminated following mergers or acquisitions. Sales trends are mixed, with underlying trends somewhat hard to discern because of restructuring of the industry.

Most insurance companies do not seem to be experiencing general labor market pressures. The market for some specialties, particularly information technology (IT) workers, remains tight. However, contacts suggest that the degree of tightness in the IT labor market varies considerably by geographic area within New England.

## SECOND DISTRICT--NEW YORK

The Second District's economy continued to run flat out in early 2000. Labor shortages intensified further and there are some signs of increased wage pressures. Retail sales continued to run on or above plan in late January and the first three weeks of February. Most retailers report that inventory levels are satisfactory and that selling prices and merchandise costs are essentially flat. Housing permits picked up noticeably in January, led by a surge in the multi-family sector. Housing markets remain exceptionally tight in the New York City area, where prices continue to advance at a double-digit rate. In contrast, home prices are flat or declining in upstate New York, though sales volume has been quite brisk in most areas.

Regional purchasing managers' surveys indicate a slight pickup in manufacturing activity in January, along with ongoing input price pressures. Trucking firms are passing along some of their rising costs of diesel fuel to shippers in the form of fuel "surcharges". Finally, bankers report softening demand for consumer and home mortgage loans but a pickup on the commercial side; they also note that credit standards have tightened further and that delinquency rates have stopped declining.

**Consumer Spending**

Retailers generally indicate that sales were on or ahead of plan in early- to mid-February. Major chains report that same-store gains ranged from 3 to 7 percent compared to a year earlier; sales were also mostly above plan in January. Home goods, ranging from electronics and appliances to bedding, continued to be the strongest category, while apparel sales tended to be sluggish. Some contacts indicated that overall sales would have been a bit stronger still, if not for the storms that battered the Northeast in late January and early February. New York State is eliminating its sales tax on apparel and footwear (priced under \$110) as of March 1, but the overall impact on sales is expected to be modest. Most contacts report that inventories are at satisfactory levels, though one retailer indicates a sizable overhang of winter merchandise. Selling prices and merchandise costs are reported to be little changed

from a year ago. Two retail contacts note that they have raised wages to hold down employee turnover, but most have held the line on wages and resorted to other means (i.e., flexible hours) to attract and retain workers.

### **Construction & Real Estate**

Housing markets remain exceptionally strong across most of the District, as builders in downstate New York and northern New Jersey are struggling to keep pace with surging demand. For the two states combined, multi-family housing permits—a harbinger of future construction—surged more than 30 percent in January, after seasonal adjustment, to the second strongest January level on record. Single-family permits posted a more moderate gain in January. On an annual basis, multi-family permits jumped 13 percent in 1999, while single-family permits rose 6 percent; both were at ten-year highs. Anecdotally, homebuilders in northern New Jersey continue to report "exceptionally strong" market conditions, with prices said to be running roughly 10 percent ahead of a year ago. Due to labor shortages, building constraints, and a dearth of available land, builders say they are unable to bring enough supply to market to meet growing demand. An industry contact notes that many builders, concerned about finding workers in the peak spring season, have already started assembling crews.

The market for existing homes in the New York City area continues to be exceptionally tight. Double-digit price appreciation is reported across most of the lower Hudson Valley, Long Island and northern New Jersey. However, unit sales in these areas remain lower than a year ago, suggesting a persistent shortage of homes on the market. Market conditions are mixed but generally more subdued in upstate New York. While home prices in metropolitan Rochester and Buffalo have declined over the past 12 months, unit sales are up sharply in these areas, as well as Albany and Syracuse.

In the multi-family segment, one leading New York City realtor indicates that the average price of a prime Manhattan apartment rose nearly 20 percent in 1999, while another reports an average rise of nearly 15 percent. More currently, prices in late 1999 and early 2000 continue to run more than 10

percent ahead of a year earlier. Finally, based on data from a leading Manhattan rental agency, average rents for newly-leased apartments rose roughly 10 percent in 1999, after jumping 13 percent in 1998.

New York City's office markets have tightened further, as availability rates fell sharply in the final months of 1999, led by strong demand from high-tech, "new media", and financial services firms, as well as publishing and law firms. Midtown's rate fell to a 14-year low of 5.7 percent, down from 7.1 percent at the end of the third quarter, while Downtown's rate tumbled from 10.6 to 9.1 percent. Manhattan office rents rose an estimated 8 percent last year, after soaring more than 20 percent in 1998; still, an incipient acceleration in the final quarter of 1999 may be signaling a return to sharper upward pressure. There are reports that Lower Manhattan's tightening office market has prompted some commercial-to-residential conversions to be reversed.

### **Other Business Activity**

Labor shortages continue to intensify in the New York City area. A major employment agency reports that salaries for "second-tier" 2000 college graduates—those who are recruited through employment agencies rather than directly—are estimated to be up 10-15 percent from last year, and that computer programmers coming off Y2K projects are being "swallowed up".

Regional purchasing managers report steady to stronger conditions in the manufacturing sector, along with persistent input price pressures. Rochester purchasers indicate that business activity continued to soften in January, while upward commodity price pressures were somewhat less widespread than during the fourth quarter. Buffalo purchasing managers report a modest pickup in manufacturing activity in January—both production activity and hiring activity remained generally flat, but new orders continued to advance at a brisk pace; commodity price pressures, which had abated slightly in December, picked up again in January. New York purchasing managers indicate a surge in manufacturing activity in January, but a pause in growth in other sectors; input price increases were somewhat more pervasive than in December, as a slight moderation in the manufacturing sector was

more than offset by increasingly widespread increases in other sectors.

A company that monitors the financial health of U.S. trucking firms reports that a number of firms recently instituted fuel "surcharges" to offset the rising cost of diesel fuel, which is up roughly 50 percent in the past 12 months. However, competition from rail carriers, which are less sensitive to fuel costs, appears to be limiting their ability to fully pass along these costs. In addition, trucking firms continue to endure severe labor shortages and growing wage pressures, with some firms reporting nearly 100 percent turnover over the past 12 months.

### **Financial Developments**

Overall demand for loans remained steady compared with two months ago, according to small and medium sized banks in the District. However, softer demand was reported for both consumer loans and residential mortgages, and most of this weakness cannot be attributed to seasonal patterns. In contrast, demand for commercial and industrial loans picked up noticeably. Refinancing demand continued to slow, with almost 70 percent of bankers reporting further declines in activity.

On the supply side, credit standards continue to tighten: approximately 15 percent of respondents reported tightening overall credit standards while none reported an easing of standards in any loan category. Bankers reported higher interest rates across the board, on both loans and deposits. Delinquency rates, which had been declining steadily for most of 1999, leveled off in all loan sectors.



## THIRD DISTRICT – PHILADELPHIA

The Third District economy was expanding moderately in February, with gains in most sectors. Manufacturers reported increases in shipments and orders. Retailers indicated that sales for the month were well above the level of last February. Auto sales were steady and above the year-ago level. Bankers noted increases in lending to businesses but a slight decline in consumer and mortgage lending. Commercial real estate markets were firm, and homebuilders said sales were steady or rising. Sales of existing homes have eased. Firms in several industries have reported rising costs, primarily for basic commodities, and a recent step-up in wage increases.

Looking ahead, Third District business contacts in most industries expect continued growth. Manufacturers forecast rising business activity and they are boosting capital spending. Retailers expect the spring season to yield year-over-year gains in line with recent increases. Auto dealers forecast steady sales at a high rate. Bankers anticipate growth in most loan categories, although at a slower pace than last year. Commercial real estate markets are expected to remain firm, but homebuilders and real estate agents expect rising mortgage interest rates to reduce sales of new and existing homes.

MANUFACTURING

Manufacturing activity in the Third District advanced moderately in February. Around one-half of the industrial firms surveyed during the month reported steady business, but more firms reported increases in shipments and orders than decreases. Gains were relatively more prevalent among producers of metal products, machinery, and industrial equipment. Some chemical companies reported increased sales as well. Manufacturers in the region continue to report difficulty recruiting and retaining workers, both skilled and unskilled. Some firms said they have had to limit production schedules as a result of labor shortages.

The outlook among manufacturers is for continued growth. Around half of the firms polled in February forecast increases in shipments and orders during the next six months, and around one-third expect business to be steady. On balance, the region's manufacturers are planning to increase capital spending. Firms indicated that expansion

is required to produce for current orders and for expected increases in orders for their products.

### RETAIL

Third District retailers reported sales in February well above the level in February last year, despite snowstorms that impeded shopping on several days. Substantial gains were posted among all types of stores—discount, specialty, and department stores. Cold weather for most of the month boosted sales of winter outerwear, helping clothing and department stores to reduce stocks of these items without price markdowns. Overall, inventories were described as appropriate for the current rate of sales. Merchants generally expect sales to continue moving up. They say early indications are that spring merchandise, especially clothing, will be popular with consumers.

Auto dealers generally reported a steady rate of sales in recent weeks. There has been a slowing in sales of the larger sport utility vehicles, according to some dealers, who attribute the relative softness to rising gasoline prices and less-than-expected consumer acceptance of the new larger vehicles. Inventories appear to have risen a bit above dealers' planned levels, but dealers expect broader manufacturers' incentives to underpin a high sales rate in the months ahead.

### FINANCE

Bankers in the Third District generally described loan growth as slow in February. Lending to businesses was rising as commercial borrowers continued to seek loans for working capital and expansion. Commercial real estate lending was also moving up. Nonbank financial institutions such as pension funds and private investors were said to be active in commercial real estate markets. Consumer lending was off slightly, on balance, at banks in the District. Mortgage activity appeared to be easing overall, although some bankers said residential mortgage applications had picked up as borrowers sought to lock in rates.

Looking ahead, most of the bankers contacted for this report expect loan growth to continue, but at a moderating rate. Several bankers said they were implementing more cautious credit terms for commercial lending, which could restrain growth in their loan portfolios. Also, bankers forecast a more modest pace of economic expansion in the region this year compared with last that will lead to a slower rate of growth in demand for

commercial credit. Consumer lending is expected to pick up, but residential real estate lending is expected to decline.

#### REAL ESTATE AND CONSTRUCTION

Contacts in commercial real estate markets described conditions as firm at year-end 1999. Vacancy rates in important office markets in the region averaged around 11 percent, up 1 percentage point from the third quarter of 1999, mainly because new buildings have become available for lease. Average rental rates rose slightly from the third quarter, according to commercial property managers, while rates for large blocks of space in new buildings increased by a more substantial amount. The pace of nonresidential construction has slowed since the first half of 1999, but contractors and real estate developers expect little further slippage this year. They expect continued work on highways, airports, and public buildings throughout the region in addition to build-to-suit construction of offices, high-tech industrial buildings, and stores in some parts of the District. Vacancy rates are expected to inch up in some areas as new buildings are added to the available inventory, but rental rates are forecast to remain stable or rise in major markets.

Homebuilders in the region reported steady or increasing sales in late January and early February. Builders said sales were somewhat stronger for homes in the lower and middle price ranges than in the higher price range. New home prices have been moving up as labor costs have increased. Sales of existing homes have slowed, according to residential real estate agents. They believe a decline in the number of homes being listed for sale is slowing the sales pace while demand for homes seems to be holding up. Real estate contacts reported that sales of second homes in prime vacation areas have been strong, although price appreciation has been moderate. Both homebuilders and real estate agents said the pace of sales will be slowed by recent increases in mortgage interest rates, although there has been an increase in home buying recently, prompted by purchasers' locking in rates before anticipated further increases.

#### WAGES AND PRICES

Reports of accelerating wage and salary increases have been received from a range of industries, notably manufacturing, services, and trade. On average, firms have implemented recent across-the-board increases around 1 percentage point higher than in

prior labor contracts. Several companies indicated that wage acceleration for unskilled and entry-level workers has become more prevalent recently than it was last year. Also, this year more firms report raising wages and salaries to retain current employees than reported taking such steps last year.

Prices of industrial commodities have been rising. Petroleum products, basic metals, and building products were becoming more costly, according to manufacturers in the region. Companies in the manufacturing and trade sectors reported that rising prices for motor fuels and other petroleum products were beginning to have an impact on their profit margins. The cost of manufactured inputs appeared to be relatively steady. Some business managers said level prices for imported manufactured goods were helping to restrain increases in overall supply costs.

**FOURTH DISTRICT - CLEVELAND****General Business Conditions and Labor Markets**

Growth in the District economy remains strong, with continued low rates of joblessness and steady wage growth. Materials prices for manufacturers are rising. However, the prices for consumer goods and the materials prices for construction are stable.

District temporary employment agencies reported a broad based increase in the demand for workers, following a seasonal holiday decline. Strong demand for administrative assistants, clerical workers, and legal secretaries continues unabated. Demand for workers with computer skills seems to have shifted away from hardware and systems workers to software and Web-based workers. Although most contacts mentioned difficulty in finding qualified personnel, none reported an inability to fill customer orders or significant wage increases. All contacts expect a steady growth in demand to continue for the next few months.

Union sources reported continued wage growth, averaging 3 per cent. They affirmed that gains are “across-the-board” instead of being skewed by a few large settlements. Pension funds have done well recently due to high stock market returns. This has been balanced by a concern over the possibility that higher health care costs will be borne increasingly by workers and less by the firms. Job security remains a high-priority issue in union negotiations.

Reports on the demand for information technology were mixed, depending on the type of services provided. Contacts who experienced an upsurge last quarter due to Y2K-related consulting expect a slowdown. Others anticipate a rise, as clients turn to development projects that were postponed until Y2K.

**Construction**

Although January sales are off from the high pace of a year ago, the level of home sales remains high. Some builders reported that existing homeowners have begun to account for a smaller share of their sales. These builders say that this could indicate a weakness in demand, because potential buyers may not be able to sell their existing homes. Cost pressures for both materials and labor continue to be subdued.

Commercial builders reported a large increase in publicly funded construction. They also reported an increase in the construction of industrial facilities and office buildings. This is driven, in part, by increased demand from the manufacturing sector. Warehouse space for Web-based businesses is in high demand, but retail space is characterized by some as being overbuilt. One contact suggested that the labor market was so tight that it could cause a wage increase on the order of 5 to 10 percent. Finding subcontractors has also become very difficult due to the high demand for construction.

In general, materials prices for construction are flat.

### **Industrial Activity**

Industrial equipment demand is very strong, and there are indications that much of the growth that has been concentrated in the high-tech sectors is also being seen in machinery, steel, and autos. One contact reported growth rates of 6 percent for industrial machinery in orders. Weak farm prices have decreased the demand for agricultural equipment, but this trend has flattened out in recent months. Industry analysts agree that rising gasoline prices have hurt this industry, although predictions for the decline in demand for heavy trucks range from 5% to 25% for the year 2000. The demand for light trucks continues to be very strong.

In recent months the combination of strong demand and declining imports has caused steel prices to rise. Some companies announced spot market steel price increases of \$20–\$25 per ton for hot rolled, cold rolled, and coated products, effective for January shipments, and an additional \$30 per ton effective for April shipments. Demand continues to be strong. However, last year's steel-price decreases and raw-material-price increases have caused most companies to report losses for 1999. Some companies expect to see improvements this quarter, but others do not expect major improvements until the end of the second quarter of 2000. Several companies have announced small job cuts recently.

Purchasing managers in the District reported an increase in the growth rate of commodity prices in January. Higher prices were reported in primary metals, engineered polymers, memory chips, PVC resin, and steel. After several months of reductions, inventories of raw materials are starting to be rebuilt. Inventories of finished goods

continue to drop. Both production levels and new order levels were mixed, but more companies reported higher levels in January than lower.

### **Consumer Spending**

Several contacts reported slower sales, which they attributed to the severe weather conditions during most of the month rather than to a more fundamental decrease in demand. Overall, however, most of our contacts reported that their inventories are consistent with their plans. None of the retailers reported price increases. Expectations for spring are quite positive, with most retailers expecting moderate-to-strong sales increases overall. Internet sales by regular retailers continue to grow but remain a small portion of their overall sales.

Sales of new vehicles have generally slowed for the month of February. However, sales in January were good, despite the bad weather. The February slowdown was anticipated, and inventories, which had been reduced by the brisk holiday sales, are now at more normal levels. Dealers did not believe that high gasoline prices would significantly affect sales, and they foresaw continued strong sales for the next few months.

### **Banking and Finance**

Sources in banking report that lending activity in the District is down for both commercial and consumer loans due to recent rate increases. The rate for loan delinquencies is slightly up. This is said to be a seasonal variation caused by heavy Christmas spending.

Credit quality is thought to be high, as banks report being very selective in accepting loan applications. Most banks already have a very high loan-to-deposit ratio both because of strong credit demand and because depositors are finding alternative instruments to bank liabilities. Willingness-to-lend levels remain high, but all banks reported that it is very difficult to attract deposits at rates that will provide a healthy margin for them.

The spread between borrowing and lending rates is shrinking due to competition. Small banks reported that bigger banks toughen the competition by offering lower rates.

**FIFTH DISTRICT – RICHMOND**

**Overview:** The Fifth District economy advanced at a quicker pace in January and most of February, driven by strong retail sales and robust manufacturing activity.

Retailers reported markedly higher sales including sales of big-ticket items.

Manufacturing activity accelerated in recent weeks; capacity utilization and new orders advanced at the strongest rates seen in several years. Contacts at services firms noted moderately increased revenues and employment during the period. Real estate activity expanded at a moderate rate despite higher mortgage interest rates. Lending activity, in general, remained strong. In labor markets, wage pressures picked up somewhat in manufacturing and in retail, but eased in the services sector. Prices rose only modestly in most sectors of the District's economy.

**Retail:** District retailers reported much stronger sales growth in the weeks since our last report. Although winter storms slowed customer traffic at some stores in late January, shoppers opened their wallets in February. Customers suffering from cabin fever after several days at home bought ravenously, according to a New Bern, N.C., contact. Big-ticket sales growth was strong throughout February, especially for automobiles and home furnishings. While inventories increased slightly since the last report, a number of retailers reported that deep price discounts on Presidents' Day helped move out winter merchandise and clear space for new spring lines. Retailers trimmed workforces in February, but modest upward wage pressures persisted. Retail prices rose only modestly in recent weeks.

**Services:** Revenues at District services firms grew at a moderate rate in the last two months. Contacts at electric and gas utilities reported their revenues were boosted by soaring demand during the late January cold snap. Revenues at business services and computer consulting firms rose moderately as their customers reinitiated projects that had been put on hold while Y2K problems were addressed. A computer networking contact in Charlotte, N.C., noted a pickup of new business within the last month. Services providers added employees at a faster rate, while wage and price pressures remained subdued.

**Manufacturing:** District manufacturing activity strengthened considerably in recent weeks. Manufacturers recorded solid growth in new orders and a sharp increase in capacity utilization in January, and they noted a pickup in growth in February. Contacts in the chemicals, food, electronics, paper products, and fabricated metals industries



reported exceptional strength in shipments in the last several weeks. On the employment front, the level of manufacturing employment was little changed since our last report, but manufacturing wages and the average workweek rose. Raw materials prices also moved higher as the effects of higher crude oil prices were more broadly felt by District producers. Tire and rubber manufacturers, in particular, noted that they now expect hikes in raw materials prices to outstrip gains in prices received during the next six months.

**Finance:** District loan officers reported that the level of lending activity changed little in January and February. Commercial lenders told us that generally strong loan demand persisted despite higher interest rates. A commercial banker in Norfolk, Va., said that higher interest rates had actually increased loan demand in the short run because borrowers wanted to lock in rates now rather than risk future rate increases. In addition, a commercial lender in Greenville, S.C., said that he was negotiating more fixed-rate loans because of borrowers' concerns that interest rates will rise further. Residential mortgage lenders reported little change in loan demand.

**Real Estate:** Residential real estate activity advanced at a moderate pace in January and February. Realtors described the District of Columbia market as strong, and they said that Northern Virginia was the hottest submarket in that region. In contrast, home sales were reported to be weaker in southern Maryland, and mixed in the Baltimore area. A Frederick, Md., contact indicated that home prices rose substantially there in recent months, and he expressed concern that lower income buyers were being shut out of the market. Contacts in Richmond, Va., reported a dip in home sales, but realtors in Virginia Beach said sales there remained strong. Construction and home sales advanced at a normal pace for this time of year in North Carolina, aided in part by continued rebuilding in areas affected by last year's flooding. In upstate South Carolina, however, contractors were reportedly turning away work because of a lack of skilled labor. Across the District there continued to be scattered reports of rising labor and materials costs.

In commercial real estate, construction advanced at a seasonal pace and lease rates showed some signs of upward pressure in recent weeks. Realtors in the District of Columbia said that the market for Class A office space was tightening and that lease rates were rising. In that market, about a half-million square feet of speculative office space was under construction in Montgomery County, Md. In addition, a substantial amount of construction was underway in Northern Virginia, primarily for information technology

companies. Retail and office vacancy rates in Richmond, Va., were described as starting to decline, while lease rates remained firm. In Charlotte, N.C., commercial construction was reported to be about average for this time of year, and buildings under construction were about 50 percent pre-leased. South Carolina realtors noted a slight tightening in the office market in Columbia, and said that lease rates inched up a little recently.

**Tourism:** District tourist activity continued to be mixed. Snow and ice storms in late January caused a large number of cancellations and early departures at coastal resorts. February snowfall, however, increased the snow base and business at area ski resorts. A manager at a ski resort in Virginia reported that his business doubled whenever there was as much as four inches of snow in the area. A West Virginia counterpart also reported good business, noting that bookings at his resort were up 35 percent compared to a year ago. Looking ahead, tourism industry contacts expressed concern that rising gasoline prices could reduce their business through the spring and summer.

**Temporary Employment:** Demand for temporary workers rose in the weeks since our last report. Although some District retailers trimmed their payrolls in January, many increased their workforces to help with the transition to new spring lines. Administrative workers with computer skills still topped the most-wanted list at many firms; technical programmers ranked a close second. Despite widespread skilled worker shortages, wage increases were said to have moderated over the past six weeks.

**Agriculture:** Mild weather in early January allowed District farmers to make good progress working fields. Winter storms later in the month, however, brought heavy snow, sleet, and freezing rain to the region. The precipitation from the storms helped replenish soil moisture and groundwater, and the snow helped to insulate small grains from freeze damage. But District pastures were covered with snow for extended periods of time, making supplemental feeding of livestock necessary in some areas. These supplemental feedings resulted in a shortage of hay in West Virginia and Maryland and forced some producers to substitute more costly alternative feeds.

**SIXTH DISTRICT – ATLANTA**

**Summary:** Contacts in the Southeast indicate that the District economy continues to expand at a robust pace and the outlook remains positive. Retail sales have been strong, although growth has eased slightly recently. District builders said that the pace of single-family construction in January was below a year ago, while nonresidential District construction has tailed off in some areas. Factory production and new orders have slowed, but contacts expect manufacturing activity to improve in the near term. Despite continued weakness in some business sectors, overall loan demand remains high, and the outlook for the tourism and hospitality sector is mostly upbeat. Tight labor markets continue to negatively affect the District, and there were scattered reports of accelerating wages.

**Consumer Spending:** Reports from retailers around the District concerning January sales were positive, with sales above year-ago levels. However, sales growth in early February was slightly weaker than during the previous month. Most merchants said that recent sales had met or exceeded their expectations. Several retailers noted they made fewer markdowns after the start of the year, boosting profit margins. Inventories were reported to be balanced by the majority of retailers. Sales of children's apparel, jewelry, and home-related products have been strong recently, while sales of men and women's apparel have varied across stores. Most merchants anticipate that first quarter sales will be up slightly compared with last year.

**Construction:** The majority of District builders contacted said that the pace of single-family construction in January declined compared with a year ago. Some noted that harsh winter weather had slowed down construction in their market. During the early part of February, builders noted a slight increase in construction levels, with fewer contacts reporting declining construction on a year-

over-year basis. However, new home sales seem to have weakened slightly in early February, with more builders saying that home sales declined from year-ago levels. Over one-half of the builders expect first-quarter construction to decline compared with last year's strong levels and construction growth in the second quarter to be flat. Realtors expect growth in home sales to slow slightly from the first quarter to the second quarter.

Nonresidential construction continued to decline overall. However, activity has not been uniform across the District. Construction accelerated in Florida, Georgia, and Tennessee, whereas activity slowed somewhat in Alabama, Louisiana and Mississippi. Speculative construction continues in several markets, but experts are cautioning that demand for office and retail space in particular will probably wane somewhat this year.

**Manufacturing:** Reports from the factory sector varied across industries. Announcements of large job cuts since our last report include a 2,500-employee reduction at Coca-Cola's Atlanta headquarters; a 2,100-job cut at BellSouth, mostly in Atlanta; and an 800-employee job cut at the Lockheed Martin plant in Marietta, Georgia. Rising interest rates have adversely affected the manufactured housing industry; one contact's sales volume has fallen by 25 percent recently. More positively, a rise in steel prices and improved production performance resulted in the first profitable month in years for an Alabama steel mill. A recovery in the paper market has led regional pulp mills to boost production. Activity is up in the lumber business, but the effects of rising interest rates on construction are expected to moderate the increases. Contacts report that the outlook for the District's energy extraction industry is very strong in light of current oil prices.

**Tourism and Business Travel:** The outlook for the tourism and hospitality sector is mostly upbeat. Advance bookings for hotels and motels in south Florida for February through April were

reported as strong. However, reservations at Panama City hotels and motels for Spring Break are down by 40 percent compared with a year ago. Year-to-date convention bookings are up by double-digits from a year ago in New Orleans. Casino gross gaming revenues were up by 13 percent from a year ago in Mississippi.

**Financial:** Despite continued weakness in some sectors, loan demand remains high overall and the availability of investment capital is unchanged for most businesses. Commercial loan demand continues to be particularly strong, while consumer and automobile loan demand remain robust. Mortgage loan volume and applications and refinancing activity continue to be depressed. Credit quality is reported as healthy overall.

**Wages and Prices:** Tight labor markets continue to adversely impact the District, and there were scattered reports of accelerating wages. Technological improvements are easing the labor shortage for some District firms, and other companies are increasing in-house training to deal with the lack of qualified workers. Many contacts indicated that overtime is being used to cover staffing gaps but expressed concern that employees can only work so much. High-tech firms in the region are reportedly spending a lot of time and resources just to maintain staffing levels and fulfill contract obligations. Some businesses are being forced to offer reduced levels of service because of a shortage of workers. One Atlanta area restaurant reportedly posted a help-wanted sign that said, "Now hiring—must have a pulse." There were a few reports of easing shortages of construction workers in the District.

More contacts than previously noted increasing prices. District farmers are particularly concerned about rising oil prices, which have boosted prices for fertilizer and some other petroleum-based raw materials.

## SEVENTH DISTRICT—CHICAGO

**Summary.** The Seventh District economy continued to expand moderately in January and February, while reports of intensifying pressure on wages and prices were isolated. Confident consumers buoyed retail spending, with contacts reporting strong sales of electronics, home-related items, and light vehicles. Business construction remained robust, and sales of both new and existing homes were stronger than expected. Overall manufacturing activity was paced by strength in light vehicle and steel production, but pockets of weakness persisted. Despite higher interest rates, lending activity remained brisk and credit quality was said to be improving. In a familiar refrain, labor markets were very tight, shortages of workers persisted, and there were a few new reports of intensifying wage pressures. District farmland values strengthened in late 1999 and were up 1 percent for the year.

**Consumer spending.** Retail sales in the District remained robust in January and February, with most contacts citing very high consumer confidence as the primary contributing factor. Virtually all of our retail contacts reported year-over-year sales gains in the mid-single digits, right in line with their expectations. Valentine's Day promotions were reported to be very successful. More generally, sales of appliances and home-related items remained strong according to most merchants, with one contact describing consumers' appetite for VCRs, DVD players, TVs, and game products as "insatiable." Inventories generally were in line with sales expectations, and promotional activity was similar to that in the same period last year. Light vehicle sales generally remained strong, although results varied by make and model. One contact noted that higher gasoline prices had not yet had much impact on demand for sport utility vehicles, which remains strong. A large auto dealer group reported that sales so far this year were down from a year ago, but had picked up in recent weeks and expects 2000 sales to be comparable to the very strong 1999 results. Another contact reported that sales of RVs and boats were very brisk. Despite continued strong demand for goods and services, reports of intensifying pressure on prices at the retail level remained isolated.

**Construction/real estate.** Construction and real estate activity in early 2000 was stronger than most builders and realtors had expected, given recent increases in mortgage interest rates. Sales results on the residential side were mixed. New and existing home sales in some areas remained softer than they had been last year, while other areas recorded exceptional

growth. In the areas where sales were soft, contacts cited concerns about increasing interest rates; in the stronger areas, they suggested that confidence in the economy outweighed any effects from higher interest rates. However, traffic through homes for sale was reportedly strong, and none of our contacts expressed concerns about a significant falloff in sales. Commercial construction remained strong in most of the District, but growth reportedly had slowed. One exception was the Chicago area market, where development of office, retail, and multifamily residential space continued to rise steadily. Three new buildings in downtown Chicago will add 3.5 million square feet to the office inventory in the next two years, even as absorption rates have slowed. The additional space is expected to keep rents from increasing substantially.

**Manufacturing.** Overall, strength in the manufacturing sector persisted early in 2000, although there was some softness in important industry segments. Resiliency in nationwide light vehicle sales kept both automakers and their suppliers operating at very high levels. Incentive spending remained high and inventories generally were still in line with sales. Strong demand for light vehicles and other consumer durable goods boosted steel production. An industry analyst indicated that steel consumption was at an all-time high with demand “dominated” by consumer-goods-producing industries. This contact also noted that inventory overhangs had been worked down and “no one even talk(ed) about them” recently. A District cabinet manufacturer reported that demand from homebuilders remained strong, and an office furniture maker said that demand was up substantially from the same period last year. Production of construction and agricultural equipment remained soft, while demand for heavy trucks was said to be slowing. Overall, the pricing environment was again soft for most manufacturers. The steel industry was one exception as previously announced price increases held, with another round of increases announced for April. Steel prices, however, were still below levels prior to the “Asian contagion” in 1997.

**Banking/finance.** Overall loan demand remained robust as business lending continued to lead the way. Lending to households, however, was stronger than many bankers had anticipated. While home refinancing activity was again weak, home-equity lending picked up, and strength in new mortgage originations exceeded most lenders’ expectations. Many contacts argued that increases in mortgage interest rates were being outweighed by overall confidence in the economy. Reports from bankers suggest a moderate improvement in consumer credit conditions. Business lending remained strong, with most evidence suggesting relatively steady

volume growth. Overall asset quality remained good, with some contacts noting that they had seen more credit risk rating upgrades than downgrades. Most lenders continued to report that competition for business loans was keeping downward pressure on both spreads and fees. Bankers' expectations for overall lending activity in the next three months were mixed, with some expecting a moderate pickup and others anticipating a modest slowing.

**Labor markets.** The pattern of very tight labor markets and slow payroll employment growth over the last few years appeared to continue into early 2000. Labor markets remained much tighter than for the nation as a whole, and employers were struggling to find and retain workers. In efforts to keep turnover down, some retailers were paying bonuses to employees after the holiday season, and a fast-food chain was offering to pay for employees' textbooks. A few contacts in both goods- and service-producing industries indicated that product quality control was becoming more difficult as a result of the scarcity of adequately skilled workers. Overall wage pressures remained generally subdued, although there were a few exceptions. Wage increases for clerical workers were again cited by contacts, and one large freight hauler cited a survey that indicated nearly a third of truckload carrier drivers had received a wage increase of 4 cents a mile (or 15 percent) over the last three months.

**Agriculture.** District farmers benefited from an increase in hog prices, which were 30 percent higher in mid-February than a year earlier. However, large supplies continued to put downward pressure on corn, soybean, and milk prices. The Chicago Fed's quarterly survey of agricultural banks indicated that farmland values rose 2 percent, on average, in the District during the fourth quarter of 1999, with Illinois and Iowa posting their first quarter-to-quarter gains in nearly two years. Bankers indicated that farm loan repayments continued to come in slowly relative to a year earlier, but the average credit quality of farm loan portfolios was unchanged from a year earlier. Several bankers indicated the performance of their farm loans was enhanced by strong crop yields and federal assistance. Many stated they had tightened their credit standards for agricultural loans, and planned to increase their use of federal loan guarantees in the first quarter. Bankers also stated they believe the number of corn and soybean acres planted with seed containing genetically modified organisms (GMO) will be stable to declining this spring, relative to last year. Nearly 96 percent of the bankers expressed willingness to finance purchases of GMO seed.



EIGHTH DISTRICT - ST. LOUIS

**Summary**

The District economy continues to operate at a high level. Reports of worker shortages at a variety of firms are still the norm. Firms and communities continue to respond to shortages with innovative training/bonus programs. Some firms have upped their starting wages as well. Residential real estate markets remain robust overall despite some slowdown in the growth rates of sales and construction near the end of last year. Banks continue to search for additional sources of funds as loan demand remains relatively strong while deposit growth is flat. Drier-than-normal weather, which has resulted in low river levels, has restricted barge traffic on the Upper Mississippi River.

**Manufacturing and Other Business Activity**

Contacts continue to report healthy economic conditions overall in the District, with several expansions leading to job growth. Wal-Mart, for example, will not only open its largest supercenter in Arkansas this fall, but will also add 250 employees at a western Kentucky store. Two new e-commerce companies in St. Louis and Memphis are creating a total of 850 jobs, and a Memphis paper products firm is adding 625 jobs. The poultry processing industry is running almost at capacity and expects costs to fall somewhat because of an abundance of feed grain.

A scattering of downsizings have also been reported, most notably the layoff, in response to falling prices, of 425 workers in western Kentucky at one of the nation's two uranium plants. Makers of commercial kitchen equipment expect a moderate slowdown this year due to higher interest rates. A dip in the demand for athletic gear led to the downsizing of an athletic store chain, eliminating 450 jobs. The sharp rise in oil prices over the past few weeks has been affecting not only customers, but also the District's trucking and transportation industry, which has been attempting to pass on the higher cost to customers because profit margins are being squeezed. On the other hand, higher oil prices have spurred a moderate resurgence of drilling

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and exploration activity at some firms in the District.

District employers still report having difficulty hiring and retaining qualified workers, which, in some cases, continues to hinder plans for expansion. Labor shortages are affecting both skilled and unskilled labor at a wide range of firms, including manufacturers, banks, hotels and retailers. In addition, the health care industry is experiencing a severe shortage of nurses. Some communities, however, are using job-training programs and expanded vocational training programs in high schools to successfully attract new workers, such as teenagers, and older and disabled people, into the labor force to help alleviate the problem.

Contacts note that some firms are raising wages to attract workers. Several fast food restaurants in some regions, for instance, are paying \$8 an hour for what a contact calls "warm bodies." In all, though, most contacts report that wage increases are in the 3 to 5 percent range. On top of higher starting wages, firms continue to offer incentives to workers who stay at a job or refer other new employees. One health care company, for example, is offering \$1,000 bonuses to new hires and \$50 awards for successful referrals.

### **Real Estate and Construction**

Despite a slowdown in home sales at the end of 1999, sales remained at high levels, making 1999 one of the best years on record, according to most real estate agents. Some regions, such as parts of northern Mississippi, even experienced record figures for residential sales in both December and January. Several agents have noted a mild uptick in the number of out-of-state buyers, which has helped support sales levels. Home prices continue to increase moderately.

New construction has mirrored sales. Monthly residential building permits in almost all District metropolitan areas were down in December, although year-to-date they were above their year-earlier levels. Despite this late-year slowing, new permit levels were still at historically high levels, especially in parts of Mississippi and Kentucky. Homebuilders continue to report

construction backlogs, although they have been declining somewhat since November. Overall, most real estate agents and builders remain optimistic about sales in early 2000.

### **Banking and Finance**

Although the demand for loans at many District banks remains relatively strong, deposit growth continues to be flat, forcing banks to seek new sources of funds. Commercial and industrial (C&I) loans and commercial real estate loans have been the growth categories, while residential real estate and consumer loans have shown some weakness. Delinquency rates of some C&I loans have recently increased moderately; however, contacts believe that this is simply a return to trend. Some bankers report that tighter interest-rate spreads have led to some higher fees. Nevertheless, a recent survey of District senior loan officers has revealed that credit standards for C&I, real estate and consumer loans have remained unchanged over the past three months.

### **Agriculture and Natural Resources**

The drier-than-normal weather that has persisted throughout the District since last fall has caused the Upper Mississippi River to drop to its lowest level since 1991. These low levels have caused some barges to run aground, which in turn has led to increased dredging activity and size restrictions on barge tows headed downstream.

In February, the USDA announced that this year's tobacco quota will be 45 percent lower than last year's. Since this is the third consecutive year of quota cuts, and since burley tobacco is Kentucky's largest cash crop, contacts are concerned that many farmers may be pushed deeper into financial trouble. In fact, agricultural lenders in general remain concerned about agricultural loans, as crop prices are expected to remain low in the foreseeable future.

## **NINTH DISTRICT--MINNEAPOLIS**

As spring approaches, the Ninth District economy continues to look very strong. Construction, manufacturing and consumer spending remain robust, energy and iron mining are making a rebound, and even agriculture shows some signs of improvement. Of the major industries, only tourism exhibits little growth. The economic strength continues to be reflected in labor markets, which remain tight, and with businesses reporting some wage pressures. However, while input prices have been rising, there are still few signs of accelerating inflation.

### **Construction and Real Estate**

Commercial construction remains bustling. Contract awards for construction projects in Minnesota and the Dakotas increased over 20 percent for the three-month period ending in January compared to a year earlier. A materials supplier in Great Falls, Mont., is unusually busy this winter, partially due to favorable weather for building. A commercial real estate firm reports that the downtown Minneapolis retail and entertainment sector is expected to expand with the addition of new hotels and increased residential development.

Residential construction is also strong. Due to low vacancy rates, the outlook for Minneapolis/St. Paul apartment building is promising, according to a commercial real estate firm. Rental rates are up about 10 percent in the Minneapolis/St. Paul area compared to a year earlier. Home prices finished 1999 up 5 percent to 9 percent compared to a year earlier for several district cities, including a 9.3 percent climb in Minneapolis/St. Paul. District housing units authorized in 1999 finished with the second highest fourth quarter of the decade.

### **Consumer Spending**

Retailers remain optimistic about current and prospective sales. A major Minneapolis/St. Paul-based discount and department store retailer reports same-store earnings for January up 5.7 percent compared to a year earlier. Electronics retailers in Billings, Mont., expect 12 percent gains in 2000 compared to last year, according to a Helena branch director. South Dakota new car and truck registrations are up 10 percent for January from a year earlier. A Montana dealership reports sales up 20 percent for January compared to a year ago.

Tourism is expected to finish flat overall, with gains in areas with normal or above normal snowfall, and losses where snowfall came late in the season. A ski area in northern Montana reports excellent snow conditions and a 35 percent increase in business compared to last year. In contrast, tourism businesses in parts of Minnesota with light snow cover are concerned. Below normal snowfall in South Dakota has stifled winter sports. "We would have a lot more business if we had more snow," says a tourism official.

### **Manufacturing**

Manufacturing in the Ninth District remains strong, although some weakness is reported in North Dakota. A January purchasing manager survey by Creighton University indicates languishing manufacturing conditions in North Dakota; however, the same survey reports a strong manufacturing sector in Minnesota and South Dakota. Examples include a 50 percent increase in sales from a year ago for a Minnesota construction materials producer, a 5 percent increase in sales from year-earlier levels for an industrial equipment company and strong sales at a Wisconsin industrial glass maker. In addition, a diecasting component manufacturer plans to build a new plant in the Upper Peninsula of Michigan. "The outlook for investment in plants is substantially stronger than earlier in the year," notes a bank director. In contrast, a North Dakota pasta cooperative reports it is shutting down its plant, and a Minnesota printing plant and a metal processing facility plan to close this year due to industry consolidation,

### **Mining and Energy**

The iron ore industry has rebounded from its slump, while Montana gold mining continues to struggle. An iron ore industry spokesperson reports full production and strong demand. November iron ore production was 1.5 percent above year ago levels, while inventory levels are down 16 percent from a year ago. In Montana, a gold mine plans to reduce production and lay off 70 workers.

Meanwhile, Ninth District oil exploration has increased as oil prices have risen. In February, nine rigs were operating in North Dakota compared to one a year ago. In addition, estimated February oil production in North Dakota was up 5 percent from year-ago levels. However, in Montana only three rigs were operating compared to five a year ago and Montana oil production is down 9 percent from a year ago.

## **Agriculture**

“Government payments have again helped our local producers get through another year,” reports a North Dakota agricultural lender. Farmers’ financial condition continues to improve based on preliminary results of the Ninth District’s first quarter (February 2000) survey of agricultural credit conditions. Farm income improved as 46 percent of respondents reported that farm income is below normal levels compared to 64 percent of fourth quarter 1999 survey respondents and 86 percent of the third quarter 1999 respondents.

Looking ahead, a continued warm winter has farmers worried about lack of snow coverage for winter grains and a possible drought next summer as a result of dry soil conditions. Moreover, some ranchers tell of problems getting water to their animals, but the mild winter continues to reduce stress on livestock.

## **Employment, Wages and Prices**

Labor markets remain taut. Shippers in Duluth, Minn., complain about “sailing short,” with a smaller crew than called for by union contract during the past year. Minneapolis/St. Paul temporary employment agencies are offering free training and starting to offer an array of benefits.

Companies are still looking for workers. A telecommunications company based in Superior, Wis., will add more than 300 jobs by early March. A major electronics retailer based in Minneapolis/St. Paul recently announced plans to add 2,000 workers at its headquarters over the next five years.

Wages continue to creep higher. An informal survey of Upper Midwest businesses conducted in January reports that wages are generally about 2 percent to 4 percent higher than last year. A major Minneapolis/St. Paul-based airline increased the bonus pay to mechanics with specialized licenses by \$1.50 an hour; custodians and cleaners received \$500 bonuses. A Fargo, N.D., hospital is offering \$4,000 signing bonuses for registered nurses.

While overall prices are not accelerating, input prices and transportation costs are increasing. Surveys of manufacturers show that input prices are higher compared to a year earlier. The Creighton University survey reports that an index of input prices for January in Minnesota and South Dakota is almost twice as high as a year ago. Through January,

the Upper Midwest business survey reports that an average of 41 percent of respondents over the past five months have reported higher input prices compared to 22 percent for the first eight months of 1999. Rising oil prices have affected transportation costs, but businesses aren't showing noticeable concern.

**TENTH DISTRICT - KANSAS CITY**

**Overview.** Tenth District economic activity remained solid in January and early February. Retail sales stayed strong after the holidays, manufacturing activity held steady, and construction activity was largely unchanged despite some further slowing in home sales. Activity in the energy sector was also stable following recent growth. In the farm economy, dry weather hurt the winter wheat crop but recent rains should help soil moisture levels. Labor markets remained very tight, although wage pressures were not quite as high as in the recent past. Some retail prices edged up, and prices for several construction and manufacturing materials continued to rise.

**Retail Sales.** Retail activity remained strong following a very robust Christmas season, with most stores reporting higher sales than a year ago. Most managers expect the strong activity to continue through the spring. Sales of home furnishings, men's sportswear, and cosmetics were especially robust in January and early February. Winter clothing and men's formal wear experienced weak sales. E-commerce activity continued to expand, helping sales for several large retailers that have their own web sites. Merchants in some rural areas of the district, however, reported being negatively affected by online retailing. Changes in store inventories were similar to recent surveys, with nearly all managers satisfied with current stock levels. Motor vehicle sales declined somewhat in January and early February, dropping roughly to year-ago levels. Car dealers remained generally satisfied with vehicle inventories, although shortages of some models of trucks and SUVs were reported. Most dealers were optimistic about vehicle sales in coming months, despite recent increases in gasoline prices and interest rates.

**Manufacturing.** District factory activity remained solid, with most plants reporting high levels of capacity utilization. An exception was the food industry, which may have experienced some payback for consumer stockpiling heading into Y2K. Most manufacturing materials



experienced few availability problems. Lead times for some materials, however, such as steel and electronic components, continued to edge up. Managers were generally satisfied with inventories in January and early February, although several plants reported plans to trim stock levels in coming months.

**Housing.** Housing starts were flat in January but still higher than a year ago. Most builders expect a normal seasonal increase in activity over the next few months. Concerns about availability continued to ease for several construction materials, including gypsum wallboard and concrete. Home sales slowed more than normal in January and were well below year-ago levels in most major cities in the district. Despite the recent slowdown in sales, inventories of unsold homes were quite low in most areas, placing some upward pressure on home prices. Mortgage demand remains much lower than a year ago, as refinancing activity has dropped off considerably.

**Banking.** Bankers reported that loans edged down and deposits were flat last month, slightly boosting loan-deposit ratios. Demand declined slightly for home mortgage loans, construction loans, and commercial real estate loans. Demand for agricultural loans edged up. On the deposit side, all major categories held steady. Almost all respondents increased their prime lending rates in the past month, and most raised their consumer lending rates as well. Most banks expect to leave their lending rates unchanged in the near future, but some expect to raise rates further. A few banks tightened credit standards.

**Energy.** District energy activity leveled off last month despite further increases in energy prices. The count of active oil and gas rigs in the district was stable in January and early February, remaining well above year-ago levels but below the previous peak in late 1997. Despite the almost year-long increase in drilling activity, oil and gas production has been restrained by uncertainty about future prices.

**Agriculture.** Dry weather this winter hurt the district's winter wheat crop, but recent rain in parts of the district should help soil moisture levels. Preliminary credit reviews indicate agricultural loan portfolios were in good condition. Most farm borrowers have been able to meet their debt obligations with the help of government payments, but some credit problems have emerged in areas where crop yields were down in 1999. Despite these problems, district bankers reported that only a few of their farm borrowers will be denied credit this year. Farmland values remained steady due to strong demand for farm real estate investment. Likewise, rental rates for farmland stayed healthy, despite low commodity prices.

**Wages and Prices.** Labor markets remained very tight, with reports of labor shortages similar to the recent past. Entry-level workers in most industries continued to be particularly difficult to find. Other positions experiencing shortages included clerical workers, engineers, computer specialists, and hourly sales workers. Wage pressures did not appear to be quite as high as in the latter half of 1999. Many employers expressed disappointment with the current pool of potential workers, and some said this has kept them from attempting to attract new workers with higher wages. Sizable wage pressures persisted, however, in sectors with a large potential for job-hopping, such as the retail and restaurant industries. An increasing number of small businesses appeared to be caught in a cost-price squeeze. Costs at these firms have been driven up due to recent wage increases, while selling prices have remained fairly steady. Some retail prices edged up in late January and early February but are expected to stabilize in coming months. Prices for several manufacturing materials, including synthetic rubber, chemicals, and solvents, moved higher and are expected to rise further due to recent increases in oil prices. Builders reported rising prices for some materials and expect continued price increases with the seasonal expansion in building activity.

## ELEVENTH DISTRICT—DALLAS

The Eleventh District economy continued to expand at a brisk pace in January and February. Demand for business services was robust, and retailers said sales continued to be strong. Overall manufacturing activity was still quite strong. Construction and real estate activity was mixed, with a rebound in home building but a softening in office leasing rates. Energy activity has been lackluster after showing signs of rebounding at the beginning of the year. Financial service contacts reported slower lending activity. Drought continues to be a serious problem for agricultural producers.

**Prices.** Price pressures were mixed with rising prices for energy products and some metals but continued price declines for some high-tech products and some construction inputs. The lowest crude oil inventories in over 20 years and OPEC's stated commitment to production cuts have pushed up oil prices since early January, despite generally lackluster demand. Heating oil prices rose above \$1 per gallon with low inventories and cold weather in late January and February, but fell back to the mid-70 cents level. Natural gas prices have remained over \$2.00 per thousand cubic feet since the new year, with spot prices hitting a high of \$2.91 on February 1. Despite higher heating oil and gasoline prices, rising crude prices are keeping refiners' margins under pressure, and refineries have sharply reduced output. Concerns that refiners are not building inventory for the spring and summer driving seasons pushed gasoline futures up to post-Persian Gulf war highs. Chemical producers say they would like to raise prices for basic petrochemicals, such as ethylene and polyethylene, to protect their margins from rising feedstock prices, and strong demand has pushed down inventories for ethylene, but excess capacity suggests producers will have difficulty raising prices. Contacts say prices for plastic products have not yet risen because prices never fully adjusted downward when crude oil fell to \$10 per barrel. One respondent warns of price increases very soon, however, for the myriad of products made from plastic, such as shower curtains, garbage bags, and squeeze bottles. Transportation firms say higher fuel prices are taking a bite out of earnings. Many have added fuel surcharges and are trying to raise prices. Brick manufacturers are considering a price hike to pass along higher natural gas prices and shipping fuel surcharges.

High-tech firms reported an easing of the tight supply of semiconductor chips. The supply of flat-panel monitors has also increased, after being in tight supply for a couple of years, and their prices are softening. Homebuilders say that cost pressures are significantly reduced from the end of 1999, with lower prices for sheet rock and cement. Manufacturers also reported lower selling prices for concrete and cement, which they attributed to increased competition.

Labor markets remain tight. Wage pressures are extreme for some types of workers, particularly those who are being demanded by Internet firms. Some service firms reported that higher wages are translating into higher fees. Some high-tech companies say wages have accelerated slightly in recent weeks, and noted that workers are demanding more pay in direct wages instead of stock options. Legal contacts say heavy competition with "dot-com" firms has caused many law practices to increase wages. One retailer said that competition is "wild" for workers with Internet experience and "compensation is dramatic." Still, some firms reported no change in wage pressures. One retailer said that workers appear to be more sensitive to workplace conditions than moderate increases in wages. This has led the retailer to 1) conduct regular surveys of worker morale, 2) offer more training opportunities and 3) encourage workers to enlist their friends as fellow employees. The retailer is also offering contests and pizza parties to improve worker retention.

**Manufacturing.** Overall manufacturing activity continued to be quite strong in January and February. Several producers noted a rebound in sales, after a slowdown at the end of 1999. Demand for lumber picked up in February, particularly for wood used in finishing work at the end of construction. Demand for concrete rebounded in February, but remained slightly below a year ago, while cement sales continue to be strong, at roughly the same level as a year ago. Brick producers say sales are setting records every month. Sales for paper products have moderated, but without a Y2K-related drop, as some feared. Metals manufacturers reported brisk sales to the oil industry but slowing demand for construction-related metals. Computer and semiconductor manufacturers said demand growth was stabilizing at a strong pace, after rebounding from a Y2K slow down at the end of last year. Demand from Asia was reported as very strong but some cooling was reported from Eastern Europe, and demand remained sluggish from France and Germany. In response to terrible profit margins, refiners reduced production sharply, reducing capacity utilization from 91 percent in November to 84 percent in early February.

**Services.** Demand for business services remained generally robust. Temporary firms reported that business has been as strong or stronger than it was in December, with good demand from all areas, particularly high-tech companies. Legal firms also reported strong demand for their services. Transportation firms said demand was slower than in December, which they attributed partly to seasonal factors, particularly for passenger traffic. Trucking, rail and airline cargo contacts wondered if they are still feeling the effect of Y2K and depressed commodity prices.

**Retail Sales.** Retailers and auto dealers reported continued strong sales. Houston area sales are picking up, after posting slower sales growth than in the rest of Texas.

**Financial Services.** Lending activity was slower according to contacts, who noted slowing in auto and mortgage financing. While some banks attribute the slowing to the typical after-Christmas slow down, others believe that higher interest rates are beginning to affect lending. Some respondents have increased reserve accounts. Most financial service contacts are optimistic but expect lending this year to be slower than in 1999.

**Construction and Real Estate.** Home building picked up in January and February after showing serious signs of slowing toward the end of 1999. Some builders say growth was significantly stronger than expected and believe interest rates are not affecting sales or traffic. One builder noted that buyers have shifted to using adjustable rather than 30-year fixed rate mortgages. In contrast, a builder focused on the “more affordable buyer” reported a pick up in sales but said sales were below last year’s level. This builder said buyers are having a harder time qualifying for loans and, although the builder has been “pushing ARMs,” the cost-conscious buyers tend to have an aversion to adjustable rate mortgages. A commercial real estate broker reports “a lot more anxiety” in the office market over the past 6 weeks. Tenant companies have increased the velocity of change—shifting strategies and changing leasing plans. There has been a sharp increase in subleasing, and one contact estimated that 16 percent of the Dallas market is currently available for subleasing, which will lead to an overall drop in absorption and leasing rates. Office leasing rates have fallen 5 to 8 percent in recent weeks and will likely fall further, according to this contact.

**Energy.** Drilling activity has been lackluster, with the domestic rig count stuck at 750 to 775 rigs and international work outside of Canada still in decline. Oil remains out of favor, with an apparent turn to oil-directed drilling in late 1999 seeming to evaporate. After rising at the end of 1999, the “workover” rig count dropped back sharply in January. Workovers are the quickest, cheapest route to increasing oil production, as well as a leading indicator for oil-directed drilling, according to contacts. Improvement in the Gulf of Mexico has been marginal, with day rates for rigs and supply vessels flat or showing small improvement from depressed levels. Contacts say the industry “remains unimpressed” by high oil prices and are unwilling to take significant risks, choosing instead to pay down debt with the increased cash flow. One respondent stressed the financial and psychological damage that oil prices at \$10 per barrel had caused, and said firms needed to clean up the financial problems before moving forward.

**Agriculture.** The USDA has declared almost of half of Texas counties eligible for drought disaster assistance. Wheat and oat crops are in generally poor condition. Livestock conditions are poor, with heavy supplemental feeding and herd reduction. Agricultural bankers reported a decline in demand for loans, renewals or extensions. Many link the reduced demand to drought conditions that have

discouraged farmers from planting and to government assistance that has helped farmers pay off existing loans.

## TWELFTH DISTRICT—SAN FRANCISCO

**Summary**

Contacts reported strong performance by the Twelfth District economy in recent weeks, characterized by generally robust demand for final products and labor inputs. Although some wage pressures were evident, prices for final goods and most services have remained fairly stable, in part due to vigorous competition in the retail trade sector. District manufacturers reported strong demand, including some increases in export demand, although aircraft deliveries continued to decline. In addition, contacts saw few signs of capacity constraints in manufacturing. Agricultural conditions were mixed. Activity in the construction and real estate markets remained strong in many parts of the District, although slowing was reported in a few states. Financial institutions reported strong demand for credit and adequate liquidity.

**Wages and Prices**

District respondents reported continued tight labor markets and some upward compensation pressure. Prices for final goods and most services, however, remained fairly stable during recent weeks. Both skilled and entry level workers remained scarce in most District states. Respondents from the retail, agriculture, and manufacturing sectors indicated increases in wage pressures, especially for those with computer and other technical skills. In addition, contacts cited increases in benefits costs and the use of incentives such as retention bonuses and salary increases in connection with job reclassifications. Competitive pressures reportedly held down price increases in the retail trade sector. Sales of discounted products have been especially brisk, and manufacturer

incentives contributed to flat auto prices. However, the price of ready-mix concrete increased due to capacity problems and a lack of raw materials. In addition, prices for transportation and courier services increased due to rises in fuel costs and a shortage of licensed truck drivers.

### **Retail Trade and Services**

Respondents reported generally strong retail sales and manageable inventories in the survey period. One contact cited a buildup in apparel inventories as an exception. Some constraints along the retail supply chain have been apparent. Contacts in California reported slower deliveries from manufacturers, while respondents in other District states mentioned shortages of truck drivers and shipping containers. Reports from service providers indicated that advertising volume for “dot com” businesses has been heavy.

### **Manufacturing**

District manufacturers reported generally favorable conditions. For example, contacts in the pharmaceutical, biotechnology, wood products, and semiconductor industries reported strong sales. Respondents from several industries reported increased exports due to strengthening global demand. For example, a contact in the machine tool industry mentioned an improvement in Japanese demand. Respondents saw few signs of general capacity constraints or a scarcity of input goods. One contact noted that wood product inventories in the Pacific Northwest have increased in recent weeks but remain acceptable. In Washington, Boeing’s deliveries have continued to decline.



**Agriculture and Resource-related Industries**

Conditions for District agricultural producers were mixed during the most recent survey period. District beef producers benefited from rising demand and high sales prices, combined with low feed costs. However, in Arizona, ranchers have been concerned by a lack of spring grass for grazing due to continued drought conditions. District pecan crops were larger than expected and sold at good prices. An Intermountain producer reported that alfalfa prices have firmed in recent weeks. However, producers in the Pacific Northwest reported a decline in apple and pear crop yields compared to last year and increases in fresh pack and canned inventories. Low cotton and grain prices continued to affect District growers of these commodities. Increases in the prices of oil, chemicals, and fertilizers boosted farmers' costs.

**Real Estate and Construction**

Construction and real estate market activity in the District generally was strong during the survey period, although signs of slight cooling were evident in some states. In California, residential sales prices continued to rise substantially. In Washington and Arizona, residential construction and sales activity has been strong in recent weeks, but there was a report of decelerating price increases in Washington. Housing starts increased in Northern Nevada, and house prices in Hawaii were either stable or rising. In contrast, slower residential construction activity, sales activity, and price appreciation were evident in Oregon, Utah, and Idaho. Activity in nonresidential markets was strong in most District states. Structural steel delivery time increased in California in recent weeks. However, slower business construction activity was reported in Utah and some increases in commercial vacancies were reported in Arizona

**Financial Institutions**

Reports of strong financial conditions were widespread in the District during the most recent survey period. Strong loan demand was met by ample liquidity.