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

# **Current Economic Conditions**

by Federal Reserve District

January 2000

**SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS  
BY FEDERAL RESERVE DISTRICTS**

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## Summary\*

Reports from most Federal Reserve Districts indicated strong economic growth in December and early January. Economic activity was described as strong in most Federal Reserve Districts. Growth was characterized as solid in the Philadelphia and Kansas City Districts, and as moderate in the Districts of Atlanta and Chicago.

Consumer spending growth was rapid during the holiday shopping period, and many retailers expect the high level of activity to continue into early 2000. Manufacturing continued to expand in nearly every District and was broadly based across industries. Exceptions to this were in the food, apparel, agricultural equipment, and some construction-based industries. Residential real estate construction was mixed across regions, with the northeastern states experiencing an inventory shortage, the southern and midwestern states a slowdown, and the western states an expansion. Commercial construction activity varied across the country. Bank lending was mixed, with a decrease in mortgage lending that was often offset by increases in consumer and commercial lending.

Labor markets remained tight in all Districts. However, the tight labor markets did not seem to be matched with large wage increases. Most consumer prices appear to be holding steady in much of the country, although a few Districts reported moderate increases. Producer prices also appear to be flat, with the exception of rising petroleum prices.

The century rollover caused little or no disruption to commercial or production activity, and consumer stockbuilding was limited to increases in items such as bottled water and batteries. Few future disruptions are anticipated, and few problems concerning Y2K-related inventories are expected.

### **Consumer Spending**

Retail sales attained or exceeded expectations for the month of December in all Districts except the St. Louis District, where sales increases of 4 to 5 percent were considered to be below expectations. Sales were especially high throughout the nation in

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\* Prepared at the Federal Reserve Bank of Cleveland and based on information collected before January 12, 2000. This document summarizes comments received from businesses and other contacts outside the Federal Reserve and is not a representation of the views of Federal Reserve officials.

electronics, toys, and jewelry. Several Districts reported lower-than-average sales of apparel due to unseasonably warm weather.

All regions reported large gains in e-commerce. The growth in Internet sales had a minimal reported effect on more traditional shopping, with retailers only in the St. Louis District reporting negative effects. Some retailers in the San Francisco District mentioned that e-commerce sales were concentrated in the beginning of the holiday period and that the sales stimulated competition in retail markets. Many Districts reported an increase in the intent to invest in e-commerce as a result of the high sales.

Auto sales were high throughout the country, especially for sport utility vehicles and light trucks.

### **Manufacturing**

Industrial activity was generally strong throughout the country. The Boston, Cleveland, Chicago, St. Louis, Minneapolis, Dallas, and San Francisco Districts all reported robust growth in manufacturing. Philadelphia reported new orders just holding steady, although shipments were rising. Richmond reported a moderate increase in new orders. New York and Atlanta reported steady activity, and Kansas City reported a drop-off from previous high levels.

The advance in manufacturing activity has been broadly based. The Boston District reported strong growth in semiconductors and paper, and Philadelphia in lumber, plastics, and metal products; Cleveland reported export-driven growth in heavy machinery and domestic-driven growth in electronic building components and steel; Richmond reported increased shipments in machinery, metal products, and electronics, and Atlanta in chemicals, paper, drugs, and high-tech products; Chicago indicated strength in autos and steel, St. Louis in high-tech products, paper, wood products, and electrical equipment, and Dallas in construction materials (except for cement and concrete); finally, San Francisco reported strength in high-tech products, drugs, and chemicals, driven by both domestic and export demand.

However, some industries are contracting in some regions. Notably, demand for agricultural equipment (in the Chicago District), apparel (in the Atlanta District), textiles, foods, and tobacco (in the Richmond District), and cement and concrete (in the Dallas District) were all reported to be soft.

**Real Estate and Construction**

Residential construction was mixed across Districts. The Boston and New York Districts both reported low inventories of homes, with new construction limited by shortages of construction labor and buildable land. The Philadelphia District, however, reported a decline in demand for construction labor. The Cleveland, Richmond, Atlanta, Chicago, Minneapolis, and St. Louis Districts all reported slower residential construction activity. On the other hand, the Kansas City District reported steady residential construction, and the Dallas and San Francisco Districts (where home inventories are tight) both reported high levels of residential construction activity. Where residential construction has slowed, higher interest rates were often mentioned as the reason.

Commercial construction also varied across Districts and did not always follow the residential construction patterns. In the Cleveland District, commercial construction is growing. In the Richmond District, increased city vacancy rates reportedly led to reduced construction activity. Commercial construction is booming in Florida, while it is slowing in other parts of the Atlanta District. In the Chicago District, there is a slight slowing, although vacancy rates are low. In the St. Louis District, construction is steady; in the Minneapolis District, it is high, although vacancy rates are rising. In both the Dallas and San Francisco Districts, commercial construction is strong.

**Agriculture and Natural Resources**

Low prices for cereal crops continued to affect farm incomes, although farmers in Missouri mentioned that foreign demand for these products was picking up. The winter wheat crop generally looks good in much of the country, while agriculture in Texas is suffering from a drought. Hog producers are reducing their herds in response to low pork prices. The Minneapolis, Kansas City, and San Francisco Districts all reported that cattle producers are doing well, with a combination of high beef prices and low feed prices.

Increases in oil prices have led to both the activation and building of new rigs in the Minneapolis and Kansas City Districts. The Dallas District reported new drilling for natural gas. Increases in steel production have stimulated greatly increased iron ore production in the Minneapolis District.

**Financial Services and Credit**

Bank lending was mixed across Districts. Philadelphia, Cleveland, Richmond, Atlanta, Chicago, and San Francisco reported strong growth in loans. St. Louis and

Dallas reported flat lending, and New York indicated a seasonal softness. Even those Districts reporting growth in total loans often indicated a softness in mortgages, particularly in refinancings, due to higher rates. These were more than offset by strength in consumer and commercial loans.

The New York and Cleveland Districts reported that delinquencies were down and credit standards were higher, while Richmond reported less stringent loan requirements. Standards were reported unchanged in the Chicago and Kansas City Districts.

### **Employment**

All Districts reported tight labor markets. Atlanta reported that Florida help-wanted ads are at record volume. Specific categories of employees in especially short supply included office managers (New York and Cleveland), high-tech workers (Atlanta, Dallas, and San Francisco), nurses (Atlanta, Minneapolis, and Kansas City), truckers (Kansas City and Dallas), and pharmaceutical workers (Minneapolis and San Francisco). Increasing numbers of construction workers are looking for work due to soft demand in Philadelphia and Minneapolis while they are sought by employers in Atlanta, Kansas City, and St. Louis.

### **Wages and Prices**

Wage increases varied throughout the country. The Cleveland, Atlanta, Chicago, Kansas City, and St. Louis Districts reported stable wages or moderate increases that are consistent with productivity gains. Richmond reported moderately strong increases in the retail and service industries. Dallas reported wage increases for truckers and lawyers. Minneapolis said that an increasing fraction of firms was planning wage growth of at least 4 percent. Many Districts indicated that wage pressure is being met by non-wage benefits such as stock options, bonuses, and increased health benefit coverage.

Most Districts reported steady consumer prices. Businesses cited competition and increased productivity as reasons for not increasing their output prices, even in the face of increases in the prices of some raw materials. There were some exceptions, however. The Minneapolis District noted signs of accelerating inflation, including reports that many consumers expect the Consumer Price Index to rise by more than 3 percent and that a rising percentage of firms plan price increases. Philadelphia reported planned increases during the year 2000, Richmond reported moderate price increases in both the retail and

service sectors, Boston noted rising hotel prices, and New York reported sharp increases in real estate prices in the New York City metropolitan area.

Input prices were usually reported as being flat with the exception of energy inputs, which are rising in price. Several Districts reported anticipated steel price increases. San Francisco reported raw materials price increases in logs. San Francisco also reported steady declines in the prices of telecommunication and Internet services.

### **The Effect of Y2K**

There was little impact of the Y2K computer bug. Most Districts reported only minor disruptions, such as an increase in consumer demand for items like bottled water and batteries. Even this demand was described as such a small portion of the overall business that inventory disruptions were minor. There was little or no producer stockpiling in anticipation of the event. Banks indicated that Y2K caused no liquidity problems and that less cash was withdrawn than anticipated.

The Richmond District reported a fall in tourism that may be Y2K related. The Dallas District reported some uncertainty in cargo demand due to possible Y2K stockpiling and some unemployment of information technologists. This was unusual in that several Districts reported more information technology employment opportunities for expected increased computer-related business now that Y2K efforts have largely passed. The Richmond District reported temporary employment agencies are having no problems placing temporary computer workers, who have been released from Y2K projects, into new jobs.

**FIRST DISTRICT—BOSTON**

Reports from businesses in the First District continue to be quite positive into the early days of 2000. Retail sales growth from year earlier was “solid” and exceeded retailers’ expectations for the holiday season. Over half of the manufacturers contacted enjoyed more business in late 1999 than in late 1998. Employment at responding firms in the region is generally level. Labor markets remain tight and overall pay increases are in a 3 to 6 percent range. Goods prices are said to be mostly unchanged. Contacts report no significant effects of Y2K on their business activity.

**Retail**

Most retail contacts report solid sales growth during the holiday period. These firms’ mid-to-upper single-digit growth rates were slightly better than their own sales projections. Inventories are at desired levels. Because retailers were generally confident that their suppliers were Y2K-compliant, no contact reported raising inventories before the new year. Retailers report particularly strong growth from sales over the Internet, with one catalog merchant saying that web sales now constitute 10 percent of the company’s business.

Employment is said to be holding steady. Most retail contacts report that wages are growing at a 4 to 6 percent pace. All contacts indicate that the labor market is very tight and some are having difficulty finding help. Raiding of permanent employees is reported to be common.

Most retail contacts say that consumer price inflation is nonexistent and that vendor prices are either holding steady or, in many cases, declining. One exception is in the tourism sector, where the price of hotel rooms has been increasing for quite some time. Retail gross margins are said to be either holding steady or rising. With the exception of tourism, contacts stress that rising profit margins are due to cost reductions rather than price increases.

Looking forward, retailers are optimistic that consumer demand will remain strong throughout calendar year 2000. Most retail contacts say that they plan to expand their operations in the coming year. Such expansions are not always with brick and mortar, however, as many say they are investing heavily in e-commerce.

**Manufacturing and Related Services**

The majority of First District manufacturing contacts report that business in late 1999 was up relative to a year earlier, and almost all expect positive trends in 2000. Very strong order or revenue growth is reported in the semiconductor industry as well as by makers of computer and power equipment. Contacts indicate that conditions in the paper and textile industries have firmed or improved, but demand for industrial machinery and products used by rail companies remains soft.

Contacts report that Y2K had little if any impact on business. A paper maker, an auto parts supplier, and a bottled water manufacturer detected signs of added sales because of Y2K, but each describes the impact as selective and small in proportion to overall business. A few companies engaged in precautionary stocking--chiefly selected items imported from Asia--but most companies made no adjustments.

Manufacturers are reporting rising costs for petroleum-based products (especially plastics), silicon, glass, selected chemicals, equipment from Asia, and citrus fruits. In some cases, contacts are not yet feeling the full brunt of market price increases because of favorable relations with suppliers or long-term contracts. Otherwise, most materials costs are said to be holding steady, as are most selling prices.

Most respondents indicate average pay raises in the range of 3 to 5 percent, with greater increases at some technology-oriented businesses. Manufacturers generally say that labor markets remain tight. Some contacts indicate less frustration in finding and retaining production help than a few months ago, but others indicate growing challenges.

Capital spending plans are mixed. The majority of contacts expect capital spending to be at least as high in 2000 as in 1999. These firms cite plans for capacity increases or continuing enhancements to computer systems and other equipment. Companies intending to reduce or hold down expenditures mostly cite financial constraints, although a few respondents say that their recent push to upgrade information systems or other equipment decreases the need for further spending.

### **Residential Real Estate**

The residential real estate market in New England has remained steady over the past quarter. Contacts report limited activity in most areas, but attribute it to the usual seasonal slowdown rather than any long-term changes. Selling prices rose at an above-average pace in Massachusetts and New Hampshire in 1999. Sales volumes in 1999 did not vary much from their 1998 levels, in part because of low inventories in many areas. In Massachusetts, for example, the number of listings at the end of the third quarter of 1999 was reported to be 20 percent below the comparable number in 1998. Contacts anticipate an active spring season, based on some early signs of increased activity levels and strong demand in most states.

**SECOND DISTRICT—NEW YORK**

As the new year begins, economic growth in the Second District shows few signs of slowing, while price pressures remain moderate, on balance. Labor shortages are said to be increasingly severe, particularly for office workers. Retail sales were reported to be fairly strong both during and after the holiday season as brisk sales of consumer durables offset lagging apparel sales; both price levels and retail wage pressures were little changed from a year ago, and inventories were said to be on target.

Home construction has retreated somewhat from the high levels that prevailed for most of 1999. Still, tight housing markets persist in the New York City area, where sluggish unit sales and surging prices are attributed to a shortage of homes on the market. Regional purchasing managers' surveys indicate mixed but generally positive conditions in the manufacturing sector, along with an easing in input price pressures. Some businesses report that Y2K concerns had a slight positive impact on fourth-quarter sales—due to consumer stockpiling—but no effect on inventories. Bankers report a normal seasonal dip in consumer and commercial loan demand but weaker demand for home mortgages; they also note a slight tightening in credit standards, and further improvement in delinquency rates.

**Consumer Spending**

This past holiday season was evidently a strong one for most retailers. Major chains report that sales in the region were roughly in line with expectations in December, with same-store gains ranging from 0 to 9 percent compared to a year earlier; sales looked to be on or above plan in early January. Home goods—bed and bath, furnishings, electronics (except computers), appliances, etc.—sold especially well, as did jewelry, cosmetics, and food. However, most contacts report that apparel sales were disappointing, partly but not entirely due to unseasonably mild weather.

Similarly, smaller retailers across New York State indicate that holiday—season-sales were up by a robust 5-7 percent from the same period in 1998, despite increased competition from the Internet. They also report brisk sales after Christmas, as deep discounts and gift certificates pulled shoppers back into the stores. Apparel retailers expect to be busy from January 15-21, when the state will be running yet another “tax-free week” for clothing and footwear priced up to \$500.

Year-end inventories are widely reported to be at satisfactory levels. None of the retailers contacted indicated any precautionary inventory building due to Y2K concerns. The only noticeable effect was on sales of flashlights, batteries, generators, bottled water, etc. Selling prices, on balance, were said to be flat compared to a year ago; however, some contacts anticipate a moderate upturn in prices in 2000, due to rising merchandise and labor costs. While small

retailers report severe labor shortages, most large chains indicate that holiday-season hiring was no more difficult than in 1998; however, one contact noted some deterioration in the quality of seasonal hires this time around.

### **Construction and Real Estate**

A persistent shortage of available homes in the New York City area is buoying prices but limiting sales volume, while land and labor shortages appear to be constraining new construction. Housing permits in New York and New Jersey rebounded somewhat in November, after falling in the two prior months, but are still somewhat below the high levels that prevailed for most of 1999. New Jersey's housing market is still reported to be tight, with homebuilders indicating a "surprising amount of traffic" in the final two weeks of December. One industry contact describes new home sales as robust but observes that they would be stronger if not for land and labor supply constraints. Both the new-home and resale markets are said to be "bereft of inventory." Long lags in construction have prompted builders in northern New Jersey to do more speculative building, largely to satisfy the relocation market—incoming business executives who cannot wait nine months for a home.

New York State realtors report that the market for existing homes remained firm in November, with less of a seasonal slowdown than usual—possibly due to unseasonably mild weather. Unit sales were up 3 percent from a year earlier, while prices continue to run 6-7 percent ahead of a year ago. In general, unit sales have strengthened in upstate New York, but weakened in and around New York City. Conversely, prices have been mostly flat upstate but have risen at a double-digit rate downstate, again reflecting a supply shortage in and around New York City. Separately, a major New York City realtor reports that "the real estate frenzy continues," with co-op and condo prices up 10-15 percent from a year ago, and total volume up 35-40 percent. A shortage of apartments on the market, though not as severe as a year ago, is still prompting some bidding wars in Manhattan.

### **Other Business Activity**

Labor markets remain exceptionally tight. A large employment agency specializing in office staffing reports a "tremendous labor shortage" in the New York City area, which "seems to get more severe by the week." Together with strong demand from existing business clients, they are getting many cold calls from other businesses desperate for workers. In addition to continued demand from the financial sector, e-commerce firms are said to be "hiring like crazy," mainly looking for people with basic educational and interpersonal skills, rather than "techies."

Regional purchasing managers' surveys indicate mixed but generally positive conditions in the manufacturing sector, along with some easing of input price pressures. Buffalo purchasing managers report little change in manufacturing activity in December—there was some slippage in

both production activity and employment levels but ongoing moderate growth in new orders; commodity price pressures were reported to be somewhat less widespread than in November. New York purchasing managers in the manufacturing sector report a further acceleration in activity in December, while those in other sectors indicate steady and robust growth; price pressures were reported to be somewhat less widespread than in November. Moreover, in response to a special question, two out of five local purchasers say that they held extra inventories “for potential Y2K problems”, though much of that appears to have been in anticipation of consumer stockpiling rather than supply disruptions. Separately, our manufacturing contacts report that Y2K concerns had no impact on business activity or inventories.

### **Financial Developments**

Demand for loans weakened over the past two months, according to small-and-medium sized banks in the district, though much of the softness—especially in the consumer segment—was described as seasonal. However, there was a particularly widespread drop-off in demand for residential mortgages, which cannot fully be attributed to seasonal patterns. Refinancing at Second District banks continued to fall, with almost three-quarters of the bankers surveyed reporting less refinancing activity and only 3 percent reporting increased activity.

On the supply side, approximately one in five bankers report a tightening of credit standards while no bankers report an easing of standards. Standards were tightened across all loan categories. A large majority of banks report increases in interest rates on all types of loans, as well as a rise in average deposit rates. Delinquency rates dropped in all loan sectors compared with two months ago.

**THIRD DISTRICT—PHILADELPHIA**

Business activity continued at high levels in the Third District at the turn of the year. Manufacturers posted increases in shipments in late December and early January, although the pace of new orders was reported to be only steady in recent weeks. Retailers generally recorded substantial increases in sales for the holiday shopping period. Auto sales remain brisk. Bankers noted increased consumer lending but decreased real estate lending. Commercial and industrial loans have been seasonally flat.

Businesses in the Third District reported very few problems with computer systems as the century date changed. Manufacturers had built up inventories slightly in case their supplies were disrupted. They plan to reduce them to normal levels in the current quarter. According to reports from stores, there was some stockpiling of bottled water, batteries, and some food items by individuals, but the buildup appeared to have only a very minor effect on normal consumer purchasing patterns. With Y2K concerns out of the way, businesses in a wide range of manufacturing, financial, and service industries say they will step up implementation of computer systems for business applications and Internet activities this year. Work on these new projects is expected to begin near the end of the first quarter, after firms are confident that their computer systems can handle year-2000 and leap-year dates.

In the Third District business community, the outlook for the new year is generally positive. Manufacturers expect orders to rise. Retailers anticipate a continuing high rate of sales. Auto dealers expect sales in 2000 to remain high but possibly slip a bit from last year's rate. Bankers forecast rising loan demand through the year, although they expect growth to ease from last year's pace. Demand for labor is not expected to slacken except in the construction sector, where a decline has already begun.

**Manufacturing**

Third District manufacturers contacted in late December and early January said that shipments were rising but new orders were just holding steady, on balance. Increases in demand were noted by firms that manufacture lumber products, plastics, primary metals, and fabricated metal products. In contrast, orders were declining at food processing plants, printing firms, and makers of electrical machinery. Firms in a variety of industrial sectors boosted inventories of inputs around the turn of the year to be prepared for possible Y2K-related supply interruptions. There were no reports of serious disruptions, and manufacturers plan to work down the additional inventories, which appeared to be minor, over the next few months.

Looking ahead, manufacturers in the region expect activity to resume its upward trend. On balance, they expect orders and shipments to rise in the first half of the year, and they foresee a slight increase in order backlogs. On balance, capital spending is slated to rise at industrial

plants in the region, and there are indications that implementation of data processing and Internet systems will accelerate now that Y2K concerns have passed. Reports that labor shortages have hampered manufacturers' ability to respond to growing business opportunities persist, although they are not widespread. Similarly, a number of firms in the region report that they are moving some production to foreign countries to obtain needed workers and to reduce costs.

Manufacturers continue to note an upward drift of input prices, but they generally indicate that competitive pressures are limiting their ability to charge more for their own products. Nonetheless, about one-third of the firms contacted for this report said they plan to raise prices during the first half of the year.

### **Retail**

Retailers in the Third District reported that sales for the holiday shopping period registered strong increases from the prior year's level. Sales rose from Thanksgiving to Christmas and were especially high in the week after Christmas. Merchants indicated that the year-over-year increase was around 6 percent, in current dollars, for stores open at least a year. Discount and club stores reported even greater increases. Electronics—especially new digital products—jewelry, and sports apparel sold well. Post-holiday inventories were generally described as being at or a bit below planned levels. Price markdowns were not widespread among stores, either before or after Christmas, although there were reports that some Internet retailers offered substantial discounts. Overall, merchants expect a good selling climate to prevail in the months immediately ahead.

Auto dealers said sales picked up during the final weeks of last year. They expect the sales rate this year to match or fall just slightly below last year's rate. According to dealers, consumer confidence has not been shaken by recent volatility in the stock market, and manufacturers' incentives are overcoming the potential negative impact of higher interest rates on sales. Dealers also noted that there is a growing consensus in the industry that fundamental demand for motor vehicles has increased; the number of vehicles owned per household has risen in recent years, and industry analysts expect this greater demand to provide a floor for the annual sales rate in future years.

### **Finance**

Third District bankers interviewed in early January said loan demand was consistent with the normal seasonal pattern consumer lending has risen, but commercial and industrial loan demand has been flat. Bankers expect consumer lending to grow slowly this year, supported by high employment and rising income, but restrained by already high household debt-levels. Commercial and industrial lending is expected to pick up by the end of the first quarter. Bankers' discussions with current and prospective business borrowers indicate that capital spending,

including spending for computer systems, may begin to rise in the spring. However, several bankers noted a decrease in the percentage of prospective borrowers that meet their credit standards, a trend that could limit lending growth this year.

Real estate lending has eased. Bankers said the decline is partly due to a drop in demand for residential mortgages and partly due to the implementation of more stringent standards for commercial real estate loans. Contacts in commercial real estate markets believe nonbank financial firms may be less willing to increase lending also, because they are focusing greater attention on operating earnings of existing properties rather than the potential profitability of contemplated new buildings.

## **FOURTH DISTRICT—CLEVELAND**

### **General Business Conditions and Labor Markets**

The District economy remains on a strong growth trajectory, with continued low rates of joblessness and, possibly, a small uptick in wage growth. Still, underlying price pressures appear to be somewhat light.

District temporary employment agencies reported a seasonal downturn in demand for general laborers. However, strong demand for administrative assistants, clerical workers, and legal secretaries continued unabated. Demand for seasonal retail help was also quite strong in December. Overall, our contacts expressed continued difficulty finding and retaining qualified workers, and an increasing number of temp agencies are offering improved benefits packages and bonuses to attract experienced workers. Continued strong demand for temporary workers is expected at least through the spring.

Union sources reported that wage growth continued to edge up in most industries, with estimates ranging from 3 percent to 3 ½ percent. Job security is still the focal point of union contract negotiations, however, and our contacts indicated that, where possible, workers seem willing to trade some wage gains for added job protection.

### **Construction**

District homebuilders reported a slowdown in home sales in the latter part of 1999. Nevertheless, fourth-quarter sales were still seen as quite good, and most builders are reporting a record number of homes built in 1999.

Commercial builders noted a steady improvement in project startups, and business in this sector is reportedly quite good. In the Cincinnati/northern Kentucky region, the pace of commercial building seems to have picked up in the past several months. In northern Ohio and western Pennsylvania, a recovering manufacturing sector is beginning to spur demand for more warehouse and industrial space. Columbus builders reported high activity levels, although the brisk pace of new building in this region seems to have slowed down a bit as of late.

The availability of building materials has improved in the industry, and accordingly, price increases appear to have eased a bit after having peaked at midyear.

### **Industrial Activity**

Auto parts manufacturing continues to post solid orders gains, and production activity in the industry is characterized as brisk. Heavy machinery manufacturing has improved somewhat, perhaps fueled by stronger orders growth from abroad. A small improvement in orders and production of electronic building components was also seen, reportedly tied to a rise in commercial construction activity. However, orders for Class A trucks fell precipitously in December, building upon a more

modest downward trend that began about midyear. The large backlog that existed early in 1999 has subsequently dwindled, and expectations for the current year have been pared down sharply.

Most steel industry contacts reported an improving demand for steel. Book orders for all steel products are improved for the first quarter. Prices are strengthening and are expected to increase further this spring. All companies reported inventories commensurate with current sales levels, although there is a general anticipation of even stronger sales numbers later this year.

Purchasing managers in the District reported a modest increase in the growth rate of commodity prices in November. Primary metals, paper, and chemicals prices were notably higher in November than earlier in the year. Manufacturers' Y2K stockpiles were small (generally less than one week's inventory), and no significant disruptions due to inventory overhangs are expected. Virtually all companies reported that business and plant operating computers were functioning normally following the transition to 2000.

### **Consumer Spending**

The fast sales pace retailers have enjoyed slowed a bit in November, damped by unseasonably warm weather. However, sales rebounded sharply in December, and year-over-year December sales growth is estimated to be at about the same strong pace as the year-to-date average. Generally, retailers expect strong sales to continue this year, but they do not expect sales to be quite as robustly as in 1999.

Few retailers built up inventories as a precaution against Y2K-related disruptions. Much of the stockpiling took the form of earlier-than-usual shipments of spring merchandise. Indeed, some retailers reported lower-than-usual inventories for the season.

Retailers with online sales outlets reported exceptionally strong sales for the holiday period. Internet sales were about four times higher this holiday season than last year. One Fourth District retailer reported that sales via the Internet were so strong that the company experienced inventory shortfalls.

Sales of new vehicles varied from steady to brisk for District dealers in December. Contacts believe that unseasonably warm weather may have helped boost new car demand. For many District auto dealers, 1999 was their second consecutive record sales year. Consumer demand for light trucks was a key factor in last year's strong sales numbers, and District auto dealers are attempting to bolster their inventories of new trucks. Our contacts foresee continued strong sales for the next few months.

### **Banking and Finance**

Lending activity in the District is strong and growing for commercial loans and stable (at a moderate level) for consumer loans. The rate for loan delinquencies continues to be very low.

Credit quality is high as banks have become increasingly selective in their loan applications. Willingness to lend remains high, but banks reported that it is very difficult to attract deposits at rates that provide an adequate margin above lending rates. Indeed, as has been the case for much of the past several years, the spread between borrowing and lending rates is reportedly narrow because of fierce competition in the loans market.

No significant Y2K-related disruptions were reported in the District, and Y2K-related currency withdrawals by bank depositors seem to have been modest overall and much less than had been anticipated. However, deposits were reportedly down slightly in December, as people satisfied their liquidity demands by cashing their regular paychecks rather than depositing them.

**FIFTH DISTRICT—RICHMOND****Overview**

On balance, the Fifth District economy expanded at a rapid pace in December and into the new year. District retailers recorded better-than-expected sales gains both during and after the holidays. At District services firms, revenues were higher and employment picked up. In manufacturing, shipments and new orders continued to show moderate gains. In contrast, real estate activity was somewhat slower in December and lending activity at District banks was little changed. In District labor markets, employment continued to grow moderately in most sectors while wages continued to advance at a brisk pace, especially at retail and service firms.

**Retail**

District retailers reported strong sales growth in December. Holiday sales generally exceeded plan and growth was much higher than a year ago. In addition, most retailers said that the holidays' momentum carried over into the new year. Retailers told us that the recent vibrant consumer spending has not been limited to the purchase of gifts; automobile dealerships and some lumberyards, for example, reported higher-than-normal sales in December. Retail prices continued to move up in recent weeks, but price increases remained moderate.

**Services**

Revenues at services sector firms expanded at a moderate pace in the weeks since our last report. Business, legal, and financial services were among the sectors with the largest gains. Some business services firms, however, indicated that the century date change had slowed their business late last year, and they now anticipate a return to more normal operations as Y2K concerns pass. A business service contact in Charlotte, N.C., for example, commented, "Now that companies realize that their computers are fine, they can spend money developing the areas of their businesses they had put on hold." Prices in the services sector have been growing at moderately faster rates in recent months, and in December, the trend remained intact.

**Manufacturing**

Manufacturing activity continued to expand in December. Shipments grew at a slightly faster pace than in November, while new orders rose moderately. Shipments at industrial machinery, primary metals, and electronics firms were notably higher. One Fifth District manufacturer told us that deregulatory trends in the electric industry had resulted in higher sales and orders for power plant equipment. Orders for their equipment were now booked well into 2002, as opposed to the normal booking period of only six to nine months ahead. In contrast, food, tobacco, and textiles manufacturers reported declines in their shipments and new orders. Although prices for most raw materials were relatively flat, several manufacturers noted sharply higher steel and crude oil prices.

**Finance**

District bankers said that the level of lending activity changed little in December. Commercial lenders reported that loan demand had been strong and they expected demand to remain strong into 2000. A Norfolk, Va., banker said "business was as good as I've seen in a while" and several other lenders noted "good deals in the pipeline." A commercial lender in Greenville, S.C., told us that while loan demand had been only average in December he expected some pick-up in activity this quarter from businesses that had delayed borrowing until after Y2K concerns passed. Residential mortgage lending continued to be slowed by higher interest rates. A loan officer in Virginia said that with mortgage demand weakening, competition for customers had intensified. She reported an increase in her bank's efforts to market loans to customers with less attractive credit histories.

**Real Estate**

Residential real estate and building activity in the District slowed to average or slightly below average levels for this time of year. A contact in Baltimore, Md., said that housing starts were flat but that buyer interest in senior citizen oriented condominiums had picked up. Some slowing in housing starts--beyond the expected seasonal slowdown--was reported in the Carolinas. In Virginia, realtors said sales were either at seasonal levels or slightly lower, with the exception of the Northern Virginia market, which remained generally strong. Homebuilders in West Virginia reported stable to slightly slower demand for houses, with some softening in prices. Shortages of bricks persisted in the District, particularly around Baltimore, Md., and Charleston, W.V. Wallboard was also still in short supply in scattered areas, but the availability is reportedly improving. Prices of lumber and wallboard peaked last fall, and have remained fairly stable in recent weeks.

Commercial real estate slowed somewhat more than usual in recent weeks, except in the Maryland suburbs of Washington, D.C., and around Charlotte, N.C. Office and retail rents were said to be flat in the District of Columbia. A contact from Columbia, S.C., told us that downtown office space was in ample supply, but that suburban office space was tight. In Richmond, Va., a realtor noted that vacancy rates for industrial space had increased recently, and as a result, rents were expected to soften during the first quarter of 2000. In Charleston, W.V., a slowdown in office and retail leasing activity was said to reflect, in part, more professionals purchasing rather than leasing office space.

**Tourism**

Tourist activity was mixed in December. Contacts at area ski resorts reported record attendance in December, but bookings for the New Year's weekend were spotty. A manager at a ski resort in Virginia

said that business during the weekend was only half of last year's level; he attributed the decline to more people working this New Year's eve. A contact at a ski resort in West Virginia, however, said that business was very strong during New Year's weekend because of attractive resort prices and an abundance of snow. Tourist activity along the District's coast was adversely affected by Y2K concerns; a Virginia Beach hotel manager said that the "Y2K hype" had sharply reduced bookings for the New Year's weekend.

### **Labor Markets**

Employment in the Fifth District increased moderately in recent weeks and employers continued to report substantially higher wage offers. Employment growth in the services and manufacturing sectors was stronger than in our previous report while seasonally-adjusted employment in retail was little changed. Wages advanced at a relatively strong pace in the retail and services sectors. Several business services providers added to their workforces because they expected their clients to focus on expanding operations now that Y2K concerns have eased. An operations consultant in Northern Virginia, for example, said that he plans to hire extra workers because he believes companies will turn their attention to "hotspots they had been neglecting." Contacts at temporary employment agencies said they were successfully placing temporary and contract workers that are being released from Y2K-related projects.

### **Agriculture**

Generally mild weather in recent weeks allowed District farmers to make considerable progress in their winter fieldwork. The exception was in West Virginia, where a blast of Canadian air in late December brought cold temperatures and icy conditions. Agricultural analysts in that state noted no major damage to winter grains from the storm, but they indicated that colder-than-normal temperatures necessitated greater supplemental feeding of livestock than normal. Despite substantial rainfall in most of the District in December and early January, some areas continued to struggle with dry conditions. In Virginia, a few producers reported that springs and wells had gone dry, while in western Maryland, some beef cattle producers reduced their herds because of poor pasture conditions.

**SIXTH DISTRICT—ATLANTA****Summary**

Reports from contacts throughout the Southeast indicate that the District economy continues to expand at a moderate pace. Holiday sales were strong according to most contacts. Single-family construction is mixed by market, as are nonresidential and multifamily construction. The outlook for the tourism and hospitality sector remains upbeat. Bankers report that the century rollover went smoothly, and loan demand is described as healthy. Wages and prices continue to increase in a few sectors but overall remain stable.

**Consumer Spending.** Reports from retailers around the District were good, indicating that holiday sales were similar to national trends, exceeding year-ago levels by a healthy margin in most cases. Electronic goods sales dominated in most parts of the region; toy and jewelry sales were strong as well. Apparel sales were slow in some markets as some retailers noted that the weather was too warm despite the advent of cool temperatures during December. Inventories are generally balanced. E-commerce continued its substantial growth this holiday season. A dominant online retailer with a substantial distribution center in the region reported fourth-quarter sales more than doubled from last year. It was able to deliver 99 percent of its holiday orders on time. A delivery company, which handles a large volume of online sales, experienced few Y2K or holiday delivery difficulties. Looking ahead, District retailers expect that sales during the first quarter will be flat to slightly up compared with a year ago.

**Construction.** The pace of single-family construction within the District has varied considerably from market-to-market during November and December. Half of the builders contacted said that new home sales were flat during November compared with a year ago. For December, more builders said that sales were down from a year ago. Reports from Realtors on home sales also were mixed by market. The majority of contacts report that home inventories are balanced. Looking to the future, builders anticipate home construction during the first quarter will be even with or slightly below strong year-ago levels, and construction during 2000 will be flat to slightly below 1999 levels in most areas of the District. Realtors expect another good sales year, with little change in the level of activity expected.

The pace of District nonresidential construction remains slightly ahead of a year ago but varied across the states in the District. Construction accelerated in Louisiana and Florida, but it has slowed in Georgia and Tennessee. Growth levels are little changed in Alabama and Mississippi. District multifamily construction year-to-date remains slightly above the year-ago level, although activity continues to slow.

**Manufacturing.** Factory production has held essentially steady, according to contacts. A spokesman for a firm producing security systems notes increasing business activity. Chemical

production is up from a year ago for a Mississippi firm and a large refinery is expanding in the state. Orders and production are increasing for a paper mill, and a building product manufacturer and a pharmaceutical maker are expanding to meet increased demand. A number of high-tech companies are expected to locate in the Gulf Port area in conjunction with the Mississippi Space Commerce Initiative. On a less positive note, another apparel producer plans to shutter domestic plants and move facilities overseas. One contact expects that manufacturers' purchases of computers and software will decrease dramatically in the New Year as a result of Y2K upgrades; others have pointed to a number of new projects since the New Year passed without problems.

**Tourism and Business Travel.** The outlook for the tourism and hospitality sector remains positive. In Miami, hotel and motel bookings are reported to be above last year's levels. Canada's largest vacation wholesaler is expected to begin offering charter flights to the Mississippi Gulf Coast in February, further stimulating the gaming industry there.

**Financial.** Bankers expect that overall loan demand will continue to expand at a moderate pace into the New Year, and contacts report that regional financial institutions have continued to operate normally during and after the century date change. Consumer loan demand remains very strong, commercial loan activity is healthy, and mortgage demand remains flat. Consumer withdrawals, borrowing, and deposits were in line with expectations, and there were no reported liquidity problems as the year began.

**Wages and Prices.** Wages are accelerating in a few sectors, but most contacts indicate that overall labor costs are not increasing more than productivity. Labor shortages in south Florida have contractors turning away work and putting major projects on hold. Help wanted ads there are at record lineage. Expansion in the retail and fast food segments in New Orleans have been put on hold until workers become more plentiful. As before, skilled construction workers, nurses, and information technology professionals remain in especially high demand throughout the District and are commanding greater than average wage increases.

Contacts expect few significant changes in prices over the next few months. Health-insurance premiums and pharmaceutical prices are expected to continue to rise. Contacts remain mostly optimistic about current strength in the energy sector, but some are concerned about the sustainability of the improvement. Prices paid for building materials, metals, and paper are moving upward for some firms.

**SEVENTH DISTRICT—CHICAGO**

**Summary.** The Seventh District economy continued to expand moderately in November and December, while wage and price pressures remained generally subdued. Retailers in the District generally reported that holiday sales met or exceeded their expectations. Overall construction activity softened somewhat in recent weeks but remained relatively strong. Manufacturers indicated that production remained high, but pockets of softness persisted. Bankers continued to report strong demand for business loans and slowing household lending activity. Worker shortages persisted in the District while reports of intensifying wage pressures remained isolated. Farm commodity prices remained depressed and District pork producers have responded to low prices by reducing the size of their herds.

The century rollover turned out to be a non-event for nearly all of our contacts. There were no reports of significant inventory buildups ahead of, or overhangs following, the changeover period. There were no reports of major computer glitches disrupting general business operations, although a few minor problems were noted.

**Consumer spending.** Overall retail sales met or exceeded most merchants' expectations over the holiday season, with discount stores outperforming general merchandisers. Sales of traditional gift items such as jewelry, electronics, and small appliances were reportedly very strong. In addition, most merchants indicated that apparel sales, which had been soft due to warm weather, picked up in December. Inventories were generally in line with retailers' sales expectations and, as a result, there were no reports of increased promotional activities. Dealers and manufacturers indicated that light vehicle sales in the Midwest were softer than elsewhere in the country. One contact reported that casual dining receipts in the Midwest were up considerably from the same period last year, but noted that some of this strength was due to very soft sales in the year-ago period due to bad weather. An airline contact noted that traffic in December was down about 5 percent from the previous year. This contact also suggested that higher fuel prices were beginning to impact the industry's cost structure and that passing these higher costs along would be difficult. There were no reports of intensifying pressure on prices at the retail level.

**Construction/real estate.** Overall construction activity appeared to slow slightly in both the residential and business segments in recent weeks. Contacts reported that sales of both new and existing homes softened beyond a normal seasonal slowdown in December, but most continued to describe demand as "healthy." Some markets were reporting that slight inventory overhangs had developed in both new and existing residential structures, yet most contacts were not concerned about it. On the business side, construction activity appeared to moderate

somewhat. Like the residential segment, however, activity was generally described as healthy. One contact noted that office vacancy rates remained low in most major metro markets and suburban office development was "reasonably good." Demand for light industrial space, mostly warehousing, was said to be softening. The wallboard shortage that persisted through the better part of 1999 was quickly subsiding toward the end of the year while labor shortages continued to delay some projects. One contractor group noted that increasing labor costs continued to put pressure on their margins.

**Manufacturing.** Similar to our last report, manufacturing activity remained robust in the Midwest although some pockets of weakness (such as in agricultural equipment) persisted. Automakers reported that nationwide sales remained very strong in December, finishing off a record year. Most producers were predicting lower total unit sales for 2000, but increased their forecasts slightly in recent weeks. In spite of strong demand, the pricing environment remained soft and most producers expected to continue heavy use of incentives. A large producer of office furniture indicated that demand, which was weaker than expected for much of 1999, picked up in November and December. In addition, furniture demand may receive a boost in the new year as companies free up some of their Y2K-related expenditures. The region's steel industry was generally robust and new orders for the first quarter were very strong. One industry watcher noted that steel inventories were building ahead of soon-to-be instituted price increases. This contact suggested that this is a sign that most steel buyers expect the increases to hold. At the same time, a major producer of wallboard indicated that the pricing environment for their products was softening as demand moderated and imports increased.

**Banking/finance.** Overall lending activity was brisk as 1999 drew to a close, even as residential loan demand remained soft. Most contacts suggested that business lending activity was very strong and continued to pick up. One banker pointed out that business lending typically picks up toward the end of the year, partly as a result of tax considerations, but was still strong after stripping away the seasonal factors. Asset quality of business loans was virtually unchanged, but lenders reported that competition remained fierce and margins tight. Household borrowing remained soft as overall mortgage activity again was slow. Most bankers indicated that refinancing activity was "out of the picture," but new mortgage originations, while softer than a year ago, were stronger than expected. Contacts noted that consumers' cash holdings during the century rollover were up only slightly from the same period a year earlier and that any extra vault cash was being sent back to the Federal Reserve.

**Labor markets.** The Seventh District's labor markets continued to be characterized by worker shortages and, partly as a result, slower employment growth than in the nation as a whole.

Contacts in industries ranging from construction to fast food reported that labor shortages remained a concern, but had not intensified in recent weeks. A contact in Iowa noted that fast food restaurants, in an effort to find and retain workers, recently began offering health benefits to part-time workers. Reports of accelerating wage increases remained isolated, but one contact indicated that wages for the company's truck drivers were up 10-15 percent over last year. A large durable goods producer noted that upward wage pressures were building for exceptionally hard-to-fill positions on the third shift. Overall, however, there was little evidence to suggest that general wage pressures were intensifying.

**Agriculture.** District pork producers were liquidating their stock faster than producers elsewhere in the U.S. The December *Hogs and Pigs* report indicated that the size of the District breeding herd contracted 13 percent from a year earlier, while the market herd registered a 6 percent decline. Total hog numbers registered a sharp year-over-year decline in each District state except Iowa, where the decrease in the size of the breeding herd was more than offset by expansion in the number of market animals. Hog prices declined in December, but farmers were relieved that prices did not reach the extremely low levels of a year earlier. Corn and soybean prices at central Illinois terminals remained depressed due to large global supplies. Wisconsin dairy farmers face smaller returns as the monthly average milk price posted its third consecutive month-to-month decline in December, and was 30 percent below a year earlier.

**EIGHTH DISTRICT—ST. LOUIS****Summary**

The District economy continues to grow at a steady pace despite slowing in the real estate sector and ongoing weakness in the agricultural sector. Although most retailers report that holiday sales were up between 4 and 5 percent from a year earlier, many said that this growth was below expectations. Manufacturers report continued growth in demand, although shortages of workers still plague most sectors. Home sales and construction, which began to slow in late summer, continued this trend through year-end 1999. Real estate lending has, consequently, fallen off. Increases in consumer and commercial lending have offset the decline, however. The fall harvest was better than expected, and the winter wheat crop is in fair-to-good condition.

**Consumer Spending**

District retailers report average sales increases during the holiday season of between 4 and 5 percent, compared with a year earlier. Discount chains posted the strongest gains (more than 6 percent year-over-year in several cases), while malls saw overall gains in the 3 to 5 percent range. Grocery stores experienced weaker sales increases, except for a few Y2K-related goods like bottled water and certain canned goods. That said, retailers saw no other evidence of consumers stockpiling goods for Y2K. Half of the contacts indicate that sales growth this season was below expectations and cited competition from online retailers and unusually warm weather as likely reasons. The warm weather also hurt sales of winter clothes and boots, but other apparel, toys, and some electronics and household appliances were strong sellers. Retailers expect moderate sales growth of about 3 percent during the first quarter of 2000.

District car dealers report that December sales increased on average about 4 percent when compared with the same period a year earlier. However, sales were not evenly distributed. Dealers who had the inventory saw relatively strong sales gains, upwards of 20 percent in some instances. Those who did not have, or could not get, the inventory saw large sales declines. Contacts generally do not believe that recent higher gas prices affected sales, even of sport-utility vehicles and pickup trucks. Dealers are optimistic about the first quarter of 2000, with some predicting as much as a 10 percent sales increase over first quarter 1999.

**Manufacturing and Other Business Activity**

District contacts report continued overall strength in the manufacturing sector. Demand for automotive parts and appliances continues to be robust, which has led to the expansion of three plants in Louisville and the addition of 400 jobs. Other plant expansions are also under way in the District. For example, the lumber and wood products, metals, electronic equipment, paper, and high-tech industries all experienced employment gains. Six high-tech firms in the Memphis

and Louisville regions are expanding, which will add a total of 850 jobs. These firms include an Internet service center and several distributors of computer supplies, telephones and consumer electronics. International Paper Co. is adding 500 employees at its Memphis plant.

Despite the strong economy, a small number of closings have been reported, most notably a trucking company that closed in December, taking with it 1,000 jobs. A Memphis steel plant closed because of financial problems, eliminating 250 jobs, while a producer of telephone cables laid off 300 workers because of a mild slowdown in the telecommunications industry.

Tight labor markets continue to stifle some businesses, as District unemployment rates remain at record lows. Contacts report that some construction projects are still behind schedule because of high worker turnover and a lack of available skilled workers. The shortage of workers also affected retailers, who were forced to search for holiday help much earlier than usual, offer more flexible hours and, in a few cases, increase pay to compete for workers. Several Target stores, for example, raised the starting hourly wage for some of their seasonal workers by almost 50 percent. All told, though, wage increases appear to be limited.

#### **Real Estate and Construction**

Although sales of new and existing homes remain relatively high in some areas of the District, sales growth has continued to slow in most of the District. This slowing has affected new residential construction, which was down in almost all District metropolitan areas in November. Real estate agents and builders cite higher mortgage rates as a reason. Builders have also noticed an ongoing decline in foot traffic at their properties. Early indications are, though, that year-to-date residential permits hit record levels District-wide, and home sales through late 1999 remained above their 1998 levels. Nonresidential construction slowed somewhat toward the end of 1999 in many District regions, but overall is at about the same level as a year earlier.

#### **Banking and Finance**

Total loans outstanding at a sample of large District banks remained essentially unchanged between mid-October and mid-December. Real estate loans, which make up about half of these banks' portfolios, fell about 3 percent over the two-month period. These declines were offset by increases in both consumer loans and commercial and industrial loans. Meanwhile, banks continue to have trouble attracting deposits, with total deposits down about 2 percent over the same period.

#### **Agriculture and Natural Resources**

The fall harvest of corn, soybeans, rice and cotton was better than expected. The winter wheat crop appears to be in fair-to-good condition in most parts of the District, despite being planted under less-than-ideal soil moisture conditions. Recent rains have helped significantly, although some areas in Kentucky still report dry soil conditions. Foreign demand for corn and

cotton has recently picked up, but has remained unchanged for soybeans. Still, reports indicate that this uptick in foreign demand has not been enough to help some farmers meet their loan obligations. A few have started selling assets to meet their loan payments and avoid delinquency.

## NINTH DISTRICT—MINNEAPOLIS

The Ninth District economy starts the new millennium at full speed. The construction, manufacturing, energy and mining industries remain robust. Moreover, consumer spending continues to increase. While cattle producers' financial conditions have improved, other agricultural producers are still struggling. Meanwhile, the continued tight labor markets are generating hiring difficulties and wage pressure. Overall prices show some signs of acceleration.

### **Construction and Real Estate**

Construction remains strong. Contract awards for construction projects increased almost 7 percent for the three-month period ending in November compared to a year earlier. Due to an increase in federal highway funds, Montana awarded \$78 million more to contractors in 1999 than a year earlier for road and building projects. A Sioux Falls, S.D., mall is undergoing an over \$8 million expansion. In addition, a major Minneapolis area mall has recently announced a \$1 billion expansion plan for the next decade. However, some signs of future slowing are emerging as the vacancy rate for office space in the Minneapolis/St. Paul area has recently increased. Vacancy rates could reach 12 percent in 2000 from about 8 percent in 1999, according to an industry spokesperson.

District homebuilding has recently cooled down. Housing units authorized for the district decreased almost 3 percent for the three-month period ending in November compared to a year earlier. In Minneapolis/St. Paul, housing units authorized dropped over 4 percent for the three-month period ending in November compared to a year earlier. A Minneapolis/St. Paul building association representative claims the slowdown from a vigorous pace "may mean we can get our building cycle back to a normal timeframe."

### **Consumer Spending**

Retailers achieved their lofty expectations for strong holiday sales and expect increases during 2000. A Minneapolis area catalog and e-commerce distributor had 70 percent more orders compared to last year. A Minneapolis area mall reports holiday sales up over a year earlier, and a North Dakota mall manager reports sales are up 6 percent to 8 percent in December compared to a year earlier. Retailers in Sioux Falls, S.D., report the best holiday sales ever, according to an economic development official. However, outdoor apparel and sporting goods sales increases were lower relative to other holiday purchases due to the mild winter weather. Auto dealers in South Dakota report December sales above a year earlier, while North Dakota dealers report level sales. In addition, the outlook for retail sales is positive as half the retailers responding to the November Ninth District business conditions survey expect increased sales in 2000.

Tourism activity is holding steady despite lack of snow in some areas. While snow is light in South Dakota, snowmobiling and cross country skiing are under way, and downhill ski

resorts report good business. Moreover, resorts near downhill ski areas that have machine-made snow in northern Minnesota have solid bookings. In the Upper Peninsula of Michigan, which has snow cover, reservations at resorts for January and February are as good or better than last year, according to a tourism official. However, snowmobiling and cross country skiing in northern Wisconsin and Minnesota are down, according to tourism officials.

### **Manufacturing**

Manufacturing in the Ninth District remains robust, with many manufacturers optimistic about 2000. Based on the business conditions survey, 70 percent of manufacturers expect increased sales in 2000. In addition, 44 percent expect increased investment in 2000. Consistent with our survey, a purchasing manager survey by Creighton University indicates a strong manufacturing sector in Minnesota and South Dakota; however, the same survey reports languishing manufacturing conditions in North Dakota. As evidence, sales and investment are up from year-earlier levels for a Minnesota plastic product company and a Wisconsin paper manufacturer. However, a Minnesota motorcycle producer declared bankruptcy.

### **Mining and Energy**

The iron ore industry has rebounded from its slump. An iron ore industry spokesperson reported full production and strong demand. October iron ore inventory levels are down 16 percent from a year ago.

Meanwhile, with the significant increase in North Dakota sweet oil prices from \$6.05 in December 1998 to \$21.30 in December 1999, oil exploration activity has jumped. In December, 11 rigs were operating in North Dakota and eight rigs in Montana compared to six and six, respectively, a year ago. In addition, estimated December oil production in the district was up 2 percent from year-ago levels.

### **Agriculture**

The strong economy has generated increased demand for meat. High cattle prices and low feed prices are boosting rancher income. The U.S. Department of Agriculture expects cash income in 2000 for cattle ranchers to exceed their 1994-1998 average. In addition, with the mild winter, Montana ranchers report healthy animals as most livestock have been moved to the winter ranges. Meanwhile, the low crop prices and a continued dry, warm winter has farmers worried. Wheat, soybean and corn prices remain low. In addition, winter wheat producers are concerned about the lack of snow cover to protect the crop. Moreover, the dry soil conditions have farmers worried about a possible drought next summer.

### **Employment, Wages and Prices**

Labor markets remain tight as employers report difficulty finding workers. Based on the business conditions survey, 42 percent of respondents consider securing workers a serious challenge for

2000, up from 25 percent a year earlier. Minneapolis census officials are anticipating difficulty filling positions to staff the upcoming census. A 24-hour store in North Dakota hasn't stayed open all day and night for two months due to a lack of employees. A worker shortage remains for the health care profession.

Employers are boosting wages to attract workers. The business conditions survey indicates that over 40 percent of respondents plan to increase wages this year at least 4 percent or more, up from 25 percent of respondents in last year's poll. In addition, bank directors report climbing wages in urban areas, accelerating above 3 percent on average compared to a year earlier. During the holidays, retailers offered prospective hires starting bonuses, tuition reimbursements, health club and child care benefits and deep employee discounts.

Indications of price increases are growing. According to the business conditions survey, 34 percent of poll respondents indicate they will raise prices on their products and services in 2000, up from 27 percent of respondents in last year's poll. In addition, 79 percent of respondents expect the consumer price index to increase at least 3 percent in 2000. A hospital in La Crosse, Wis., plans to raise rates 8.5 percent. Rents and home selling prices are climbing in Minnesota, according to a state chamber of commerce official. Montana natural gas customers will pay 11 percent more to heat their homes this winter compared to last winter.

## TENTH DISTRICT—KANSAS CITY

**Overview.** Tenth District economic activity remained solid in December. Retailers reported exceptional holiday sales, residential construction held steady, and activity in the energy sector continued to improve. In the farm economy, crop prices remained low but cash flow problems eased due to good crop yields, higher livestock prices, and big government subsidies. The only sign of a slowdown was in manufacturing, where activity edged down after improving the previous several months. Labor markets remained very tight, with wage pressures still evident but no higher than in previous surveys. Retail prices were unchanged, while prices for some construction and manufacturing materials continued to rise.

**Retail Sales.** Following a weak autumn, retail activity during December was very strong. Nearly all stores reported higher sales than a year ago, as the holiday shopping season got off to a roaring start and stayed strong through Christmas. Most respondents reported no adverse effect on their holiday sales from on-line retailers, and a few said they had success with their own web sites. Managers generally expect solid retail activity to continue into the spring. Sales were especially brisk for gift items such as toys, electronics, and jewelry; purchases of men's and women's dress wear and business attire remained weak. Some stores began trimming inventories immediately after the holidays, yet most were satisfied with current stock levels. Retailers reported some increase in demand for precautionary items such as bottled water and batteries as Y2K approached, but most stores said they had planned for this phenomenon and therefore experienced few inventory problems. Motor vehicle sales in December were generally stable, with sales in most parts of the district higher than a year ago. While car dealers expect slower sales in coming months due to typical seasonal factors, most were satisfied with current inventory levels.

**Manufacturing.** District factory activity slowed after showing signs of improvement in recent months. Many plants that were operating at high levels of capacity utilization in October and November reported a dropoff to more moderate levels in December. Manufacturing materials remained generally available, although lead times for steel and steel products edged up. Many firms reduced their inventories in December and expect to continue trimming in coming months. Potential Y2K-related supply disruptions did not appear to concern most manufacturers.

**Housing.** After accounting for normal seasonal variation, housing starts held steady in December. Most builders also expect activity to remain stable over the next few months. Material availability continued to improve, although rationing of gypsum wallboard persisted in some areas. Home sales slowed in most of the district, but inventories of unsold homes remained

at comfortable levels. Mortgage demand declined throughout the district in December, particularly for home refinancings.

**Banking.** Bankers reported that both loans and deposits increased somewhat last month, leaving loan-deposit ratios little changed. Demand fell for home mortgage loans but rose for commercial and industrial loans and commercial real estate loans. On the deposit side, demand deposits and NOW accounts increased due partly to seasonal factors, while money market deposit accounts, large CDs, and small time deposits were largely unchanged. At most banks, Y2K concerns appear to have had little impact on loans or deposits. Almost all respondents left their prime lending rates unchanged last month, but a few increased their consumer lending rates slightly. Most banks do not expect to increase their prime rates or consumer lending rates in the near future. Lending standards were generally unchanged.

**Energy.** District energy activity continued a turnaround in December that began in the spring with rising output prices. By the end of 1999, the count of active oil and gas rigs in the district had doubled from the March low. Drilling activity remained below the previous peak in late 1997, however, and district producers disagree on whether the recent increase in prices has improved the long-run outlook for the industry.

**Agriculture.** Bankers reported that initial yearend reviews of agricultural loan portfolios are better than expected. Crop producers benefited from good crop yields and big government subsidies, which eased cash flow problems caused by low grain prices. Low feed costs and strong cattle prices boosted profits for district ranchers and cattle feeders. As a result, bankers expect relatively few of their farm borrowers to be denied credit for the year ahead. The bankers also reported that farmland values and cash rents have generally held steady, despite low crop prices.

**Wages and Prices.** Labor markets remained very tight in December, with reports of labor shortages similar to the recent past. Entry-level workers in retail trade, construction, and manufacturing continued to be particularly difficult to find. Other positions experiencing acute shortages included building craftsmen, welders, truck drivers, nurses, and professional sales staff. Overall reports of rising wage pressures were similar to previous surveys, as there were more wage increases reported by builders and fewer reported by retailers. There were, however, reports of extensive job-hopping by retail workers during the holiday season, as workers sought to obtain higher wages. Retail prices were steady and are expected to stay largely unchanged through the spring. Prices for some manufacturing materials, especially steel, continued to edge up. Further increases in steel prices are anticipated. General increases in prices for construction materials were reported and are expected to continue.

**ELEVENTH DISTRICT—DALLAS**

In December, Eleventh District economic activity remained strong. The service sector reported strong demand, and most retailers said sales were strong. The energy industry continued to rebound, but there were signs of cooling for refining and petrochemicals. Construction and real estate activity also was quite strong, with the exception of home building, which was “slower than usual.” Manufacturers reported activity at roughly the same level reported in the last beige book, but there were signs of weakening for some construction-related products. Lending activity was unchanged, and deposit growth was up. Agricultural conditions remained dry.

**Prices.** Price pressures were mostly neutral, with some upward pressure from higher oil prices but downward pressure from petrochemicals and some construction inputs. The construction industry reported a significant easing in price pressures for sheet rock, cement, and concrete, which were in short supply a year ago. Lumber selling prices have increased slightly but are lower than a year ago because dry weather has made logging easier. As Y2K concerns eased, petrochemical producers reduced inventories, which ended price increases begun last summer and reduced the price of polyethylene. Margins for major product—such as ethylene, propylene and styrene—are all below the level of a year ago. Oil prices increased from \$23 to \$26 per barrel in the past few weeks. Transportation firms have used hedging to mitigate fuel price increases, but their margins are down, and contacts are concerned about higher fuel prices. Some have instituted fuel surcharges, and others are considering surcharges. Refiners say they have been unable to increase product prices enough to make up for rising crude prices, leading to very poor refining margins. Contacts say prices for oil field equipment and services remain very competitive, with no significant increases. Day rates for offshore rigs and supply boats have bottomed out, however, and have begun to turn around slightly.

Labor markets have eased in some areas but continue to be very tight in parts of District, particularly in Austin and the Rio Grande Valley, where contacts say it is difficult to find skilled labor and wages are up. Auto dealers reported difficulty finding workers, and legal and trucking firms say they have raised salaries. Temporary service firms also reported very tight labor markets, but wage increases have been only “minor,” which one contact called “surprising.” Construction contractors, such as framers, were looking for work in December after being in very high demand for the past few years.

**Manufacturing.** Manufacturing activity remained strong in December, but some industries saw signs of weakening. Demand continues to be fairly strong for electronics and electrical equipment, particularly for communications devices. Food manufacturers reported little change in demand, with the exception a canned goods producer who noted a slight Y2K-related increase. All food manufacturers said they were happy that inventories were quite low. Paper producers said demand was up for all types of products. Demand was boosted by customers double-ordering toilet paper and napkins for Y2K stockpilers. Demand for construction-related

manufactured products was mixed—with some reporting continued strong sales and others weakening sales. Lumber producers say unusually warm weather and anticipation of increasing interest rates has kept demand strong and up slightly from last year. Demand for metal, glass and brick has also been strong. One brick company said they had the “largest number of deliveries and backlog ever at the end of the year,” which led to low inventories. Demand for cement and concrete in residential building has softened slightly in the last few weeks, however, down roughly 5 percent from last year. Refining is also seeing some signs of weakening. Weaker than expected demand and warmer than hoped for weather has resulted in high inventories of petroleum products. Holiday travel was below normal levels according to contacts, and homeowners seemed to have stocked up on fuel oil in November, which led to disappointing demand and poor margins in December. Gulf Coast capacity utilization held steady, but cuts in production are likely in coming weeks. Demand for petrochemicals remained strong in December, with domestic demand at very high levels and foreign demand continuing to improve.

**Services.** Temporary firms reported very strong demand for their services in December. One firm said it has been the “best December in ten years” and the “best quarter in recent memory.” Demand from retail and manufacturing firms was unusually strong according to contacts. Manufacturing activity usually slows for a week or so in December, they said, but only slowed for 2-3 days this year. Rising oil prices boosted demand for temporary workers in parts of the energy sector, particularly in Houston. Workers with technical and computer skills continued to be in high demand, but contacts reported fewer IT-related jobs, which they attributed to Y2K activities wrapping up. Legal firms also saw continued strong demand for their services, despite a typical December slow down in litigation activity. Transaction activity was good, especially mergers and acquisitions. Real estate activity was also strong, but contacts expressed concern that higher interest rates could slow activity. Transportation services reported weak passenger demand in December—with airlines reporting a greater than usual number of cancellations, which they attributed, in part, to Y2K concerns. Rail and trucking firms said that cargo shipments were unusually strong, which trucking firms attributed to firms filling their inventories for Y2K. Transportation firms reported unusually high uncertainty about the outlook for the coming weeks, in part, because they are unsure if people were stocking up for possible Y2K disruptions, which would result in fewer shipments in the first quarter.

**Retail Sales.** Retailers reported strong sales, with some reporting “phenomenal” sales, but others were disappointed by demand. Internet sales were explosive. Retailers said inventories are in very good shape, but some with Internet sites continue to hold a lot of inventory because they intentionally brought in huge amounts of product prior to Christmas to ensure they would be able to fill orders. They said there was little risk in pre-holiday inventory building because the

industry is fast growing, and they expect to work off the excess inventory as more consumers turn to the web. Auto dealers reported a strong December, with strong demand for all aspects of the business, including new and used vehicles, service and parts, with particularly strong sales of SUVs and trucks.

**Financial Services.** Financial institutions saw no significant changes in lending activity. Deposit growth was up, which contacts believe is partly because of year-end bonuses, partly because of rising interest rates, and partly because money that was withdrawn for Y2K is returning to the banking system. Bankers reported strong profits for the year, although contacts expressed concern that further interest rates increases would cut into profits.

**Construction and Real Estate.** Construction activity remained quite strong, with the exception of home building which was “slower than usual” in December but showed signs of picking up some in the first week of January. Builders attributed slower new home sales to higher mortgage rates and possibly Y2K preoccupation or concerns. The inventory of homes remains very tight. Contacts said warehouse activity was particularly hot, but office, commercial, and industrial activity also was quite strong. Multifamily building has pretty much dried up according to contacts, who say that banks have cut off all financing. Developers note there is a lot of money looking for deals, but they aren’t building without a buyer.

**Energy.** The energy industry continued to rebound, with the rig count up 60 percent from the trough last April. The gains have been in drilling for natural gas, which has reached near peak levels. Oil drilling has not yet rebounded, however, which a contact attributed to distrust that OPEC will sustain prices. Until recently, drilling has been mostly shallow, onshore, and vertical, which has not demanded many resources. Recently, however, drilling has picked up in the Gulf of Mexico and gone deeper. In addition, international drilling may be set for a rebound.

**Agriculture.** Conditions remained dry, although snow and rain helped improve wheat growth and pastures in some areas. Harvest of citrus, vegetables and the remaining summer crops continued, as well as land preparation for 2000 crops. Livestock conditions continued to decline, and herd reduction became more widespread. Ranchers are hauling water to livestock and increasing supplemental feeding—including burning the stickers off prickly pear cacti so livestock can eat them.

**TWELFTH DISTRICT—SAN FRANCISCO****Summary**

Reports from Twelfth District contacts indicate continued strong performance of the region's economy in recent weeks. District contacts also noted tight labor markets and modest to strong wage pressure, as well as higher raw material costs, though most final sales prices have remained relatively stable. Sales of retail merchandise and services were rapid in most District states during the survey period. District contacts stated that manufacturing output was expanding. Conditions among District agricultural producers were mixed, as prices improved for beef but generally remained relatively low for farm products. District real estate markets were strong overall, however there is evidence of a slight softening in sales volume. District financial conditions remained healthy with strong loan demand.

**Wages and Prices**

District respondents reported tight labor markets and modest to strong wage pressure, while the manufacturing sector experienced higher costs for raw materials. Contacts, however, generally indicated that final sales prices have remained relatively stable due to competition and productivity increases.

In California and the Pacific Northwest, shortages of skilled high-tech and financial-services employees have increased wage pressure and the use of stock option-based compensation. Skilled pharmaceutical workers also were reported to be in short supply. Contacts in several states had difficulty hiring holiday seasonal retail sales workers; a contact in Idaho, however, stated that part-time retail workers were willing to increase work hours during the holidays.

District contacts noted that raw materials costs have increased. Chemical manufacturers experienced increased raw material costs, as did California apparel manufacturers. Pacific Northwest wood products manufacturers reported an increase in the cost of logs; however, productivity gains have minimized the impact on final sales prices. Telecommunications and Internet-related services prices reportedly continue to decline due to advances in technology.

**Retail Trade and Services**

Respondents indicated that sales of retail merchandise were brisk throughout the District in recent weeks, with the exception of a slight slowing in vehicle sales reported in Washington and Utah. Contacts stated that holiday sales were strong both in dollars and unit volume, with sales up significantly from a year ago and seasonal discounting somewhat below year ago levels. Especially strong sales of electronic products, such as DVD players and televisions, big-ticket appliances, housewares, and apparel were noted. District retailers reported that inventory levels generally were adequate to meet demand and indicated few problems obtaining merchandise from

suppliers. District contacts noted only occasional evidence of consumer stockpiling of items like bottled water, medicines, canned food, batteries, and gasoline arising from Y2K concerns.

While most contacts experienced large increases in e-commerce retail sales, Internet sales did not detract much from strong in-store sales. Internet sales reportedly affected the timing of holiday sales this year, as on-line purchases tended to be early in the season. Additionally, District retailers indicated that the Internet has affected the retail sector by increasing brand awareness, by increasing price competition and comparison shopping for big-ticket items, and by leading traditional retail stores to initiate and expand on-line marketing efforts.

Business activity among District service providers remained strong in recent weeks, despite some declines in tourism during the holidays. Respondents reported robust demand for telecommunications and Internet-related services. In California, demand for shipping and freight services was strong. Visitor arrivals to Hawaii continued to rise as increased domestic travel to the islands more than offset sluggish foreign tourism. In contrast, Utah experienced a decline in holiday travel.

#### **Manufacturing**

Manufacturing contacts throughout the District experienced expanded output due to strong domestic demand and continued improvement of export demand. A high-tech manufacturing plant in Oregon was reopened due to improving conditions in high-tech manufacturing and the East Asian export market. Respondents found little evidence of an inventory buildup arising from Y2K concerns. District pharmaceutical and chemical producers recorded strong domestic demand and rising export demand.

#### **Agriculture and Resource-related Industries**

District agricultural producers reported mixed prices and output levels during the most recent survey period. Ranchers noted increased production and consumption of beef, as well as increased beef prices and low feed grain prices. In contrast, below break-even prices and slow sales continue to affect cotton and grain growers.

#### **Real Estate and Construction**

Real estate construction and sales activity remained at high levels in most District states, although the pace of new construction reportedly slowed somewhat, especially in the Pacific Northwest where housing construction has softened. Existing home sales reportedly were strong in most District states, although sales were down slightly from record levels in parts of Arizona. Rising sales prices were reported in the Pacific Northwest and Hawaii. Contacts stated that commercial real estate markets remained solid in most District states during the recent survey period, and commercial construction remained robust in the San Francisco Bay Area.

**Financial Institutions**

District financial institutions continued to report generally good credit conditions and strong loan demand. They also experienced a seasonally strong inflow of deposits in December.