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Summary of Commentary on _____

Current Economic Conditions

by Federal Reserve District

September 2001

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

SEPTEMBER 2001

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SUMMARY*

Summary. Reports from Federal Reserve Districts generally indicated that overall economic activity remained sluggish in August and early September, with several suggesting that activity slowed further. Back-to-school buying gave retailers in some regions a boost in sales, but overall consumer spending generally was said to be flat to down. Residential real estate markets were described as “brisk,” “strong,” or “steady” in most reports, buoyed in large part by low mortgage rates. By contrast, demand for commercial space reportedly softened further in most Districts. Manufacturing activity remained weak in nearly all regions, and the softness appeared to be broad based. Lending activity was mixed. Demand remained strong for residential mortgages, while demand for business loans was flat to down in most Districts as many lenders continued to tighten standards on some commercial loans. Relatively soft labor markets persisted in most Districts, with a few reports indicating further easing. Upward pressure on wages remained subdued, but contacts in some Districts continued to express concern about rising health insurance premiums. Upward price pressures were again restrained in nearly all Districts. Input cost pressures were said to be easing as well.

Consumer spending/tourism. Overall consumer spending remained soft in most of the country during August and early September, while upward pressures on retail prices were subdued. Over half of the District reports indicated that retail sales were flat to down in the reporting period. Atlanta and Minneapolis reported retail sales increases, as did Dallas but from very weak levels. In the important back-to-school segment, merchants in the Boston, Chicago, and St. Louis Districts noted strong sales, while those in the New York, Philadelphia, and

* Prepared at the Federal Reserve Bank of Chicago based on information collected before September 10, 2001, thus reflecting activity prior to the attacks on the World Trade Center and the Pentagon. This document summarizes comments received from businesses and other contacts outside the Federal Reserve System and is not a commentary on the views of Federal Reserve officials.

Kansas City regions had mixed, less-than-expected, and flat results, respectively. Federal income tax rebates had only a limited effect on spending in August, with New York and Chicago indicating no significant impact, while the Atlanta report suggested that tax rebates (along with heavy discounting) boosted overall sales. Minneapolis noted that state sales tax rebates helped retail sales. Consumers in many areas remained value-conscious, and large discount stores continued to outperform general merchandisers in some regions. Merchants in over half the Districts expected either flat sales or only moderate growth for the remainder of the year, with one contact in the Boston region describing the retail outlook as “grim.” Most Districts reported that retail inventories were in good shape. Total sales of new light vehicles were relatively soft in most regions, and the Cleveland and Dallas reports noted a shift toward used vehicles. Reports of tourism spending were mixed, while business travel generally remained soft. Upward pressure on retail prices appeared to ease further in some regions, and Chicago and Dallas indicated that there were more reports of price decreases than increases.

Construction/real estate. Real estate and construction activity were mixed, as the residential side remained strong, while the commercial segment softened further. Residential sales were relatively steady at high levels in most of the country, even in the Districts that reported slightly softer sales activity—New York, Philadelphia, and Atlanta. Softness was noted, however, in the demand for high-end homes in some reports, while Kansas City and Dallas indicated that overall home sales were soft in a few high-tech intensive areas. Contacts in many regions attributed much of the strength to continued low mortgage rates. District reports indicated that commercial activity remained weak in nearly all regions, and softened further in most. Downward pressure mounted on office rental rates as available space continued to increase. The amount of sublease space becoming available picked up in the St. Louis and

Minneapolis Districts, while it reportedly slowed in the Chicago and Dallas regions. Industrial real estate markets softened in one-third of the Districts, while retail development declined from high levels in the Atlanta and Chicago Districts. Hotel occupancy fell in a few regions, leading to decreased room rental rates.

Manufacturing. Overall manufacturing activity was weak again in August, but there were positive signs contained in a few District reports. Virtually all regions reported that new orders and production were weak, and nearly one-half suggested that conditions had deteriorated further. However, Boston, New York, Chicago, and Kansas City reported that the declines in manufacturing activity appeared to be stabilizing, while Richmond's manufacturing sector expanded for the first time in a year. Capital equipment spending remained weak, as contacts in some Districts reported that businesses had a "wait and see" attitude. Nearly one-half of the Districts indicated that high-tech manufacturing industries generally softened further in August. Some contacts in the Dallas and San Francisco Districts, however, suggested that the sector may have bottomed. Most Districts reported that manufacturers continued to trim inventories and many suggested that further inventory reductions were in the offing. Soft demand and stiff competition, in many cases from foreign producers, kept downward pressure on selling prices, and most input prices were reportedly flat to down. Increases in new orders and production in machine tool and shipping/packaging materials were noted by Chicago and Minneapolis.

Banking/finance. Overall lending activity was reported to be mixed, as household demand for loans remained strong in most areas while softness in business lending persisted. Over half of the District reports indicated that household lending activity remained relatively robust, with only Boston, New York, St. Louis, and San Francisco reporting a general softening. Low mortgage interest rates continued to buoy home buying and spur mortgage refinancing in

many areas. Contacts in the Boston, Philadelphia, and Cleveland Districts suggested that consumer delinquencies increased in the latest period, and New York noted rising delinquencies on residential mortgages. Reports on business lending activity were mixed, but generally indicated soft demand. Only the Philadelphia and Kansas City reports alluded to a general pickup in business lending activity, but the increases were very modest. One-third of the Districts noted a further deterioration in business loan quality, although contacts indicated that banks were well positioned to weather the increases in nonperforming or problem loans. Banks in one-third of the regions continued to tighten standards on business loans. Deposit increases were noted by Boston, Kansas City, and Dallas, while St. Louis reported a slight decline.

Labor markets. Labor markets continued to ease in most parts of the country in August with over half the District reports suggesting soft and/or softening demand for labor. Boston and St. Louis indicated that demand for high-tech workers continued to erode, while Atlanta suggested that potential employers had become much more selective and high-tech job searches had become longer. Staffing agency reports were mixed, but generally pointed to continued weaker demand. By contrast, New York reported that overall labor demand was stable, while St. Louis indicated that worker shortages persisted despite recent loosening of labor markets. Richmond, Kansas City, and Minneapolis noted a shortage of nurses. There were also signs of stabilization in manufacturing employment in a few regions. Boston noted an increase in weekly hours, and Chicago reported that a few manufacturers were calling back a small percentage of furloughed workers. There were scattered reports of moderately increasing wages but, for the most part, upward wage pressures continued to ease along with labor demand. In fact, the Cleveland report suggested that unions were trading off negotiated wage increases in exchange for job security provisions. Contacts in four Districts expressed concern over rising health

insurance costs, while those in the Atlanta and Chicago regions also noted rising liability insurance costs.

Agriculture/natural resources. Agricultural conditions were reportedly mixed across the country. Districts that span the Plains or northern portions of the Corn Belt (Cleveland, Chicago, Minneapolis, Kansas City, and Dallas) reported inadequate moisture conditions in many areas that were expected to negatively affect corn, cotton, and soybean yields. Recent rains were expected to help the winter wheat crop in some areas and provide a boost to late soybean yields, but were too late to help corn yields. Districts covering the southern Corn Belt and the southeastern states (Richmond, Atlanta, and St. Louis) reported generally favorable conditions for the corn, cotton, soybean, and peanut crops. San Francisco recorded mostly favorable crop conditions but noted that continued low market prices were stressing some producers. Chicago and Minneapolis also indicated that some bankers expressed concern about low levels of farm-derived income and the financial health of their customers.

Extractive natural resource industries were reported to be operating at high levels in most cases. The active oil and gas rig count in August was reported level to slightly lower than July in the Dallas, Kansas City, and Minneapolis Districts. Kansas City noted that drilling activity remained constrained by a shortage of rig workers. Minneapolis observed that mining activity varied across the District. Most iron mines were back in full production, following a slowdown earlier in the summer, while several nonferrous metal facilities in Montana remained closed.

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FIRST DISTRICT – BOSTON

Economic activity continues to be slow in New England. First District business contacts report sales or orders during the summer months even with or below year-earlier levels. Some respondents in manufacturing, temp help, and software say business appears to be stabilizing at low levels, but others in those industries and retailing continue to see deterioration. None of the contacted firms expect conditions to improve until next year, a rather “bleak” consensus outlook.

Retail

Most retail contacts report that sales were either flat or declining during the June through August period compared with a year earlier. While department stores, firms in the tourism sector, and stores selling furniture, building materials, computer and office technology products, and consumer electronics report flat or declining demand, back-to-school apparel sales were up from last year. An inverse barometer of the economy, sales of surplus merchandise exhibited very strong growth.

Employment levels are reported to be either flat or declining, with wage rates mostly rising at a 2 to 3 percent pace. Retail contacts say that they are discounting prices in order to move inventories; as a result, profit margins are being eroded. Retailers expect more of the same - flat to negative growth - for the next 12 months. They expect no turnaround in the economy until third quarter 2002. One retailer describes the outlook as “grim.”

Manufacturing and Related Services

First District manufacturing contacts report that recent business is slow. Most say sales or orders in the current quarter are down from a year earlier. Although some detect signs that business may be beginning to stabilize, respondents say overwhelmingly that they or their customers are still seeking to reduce inventories. Thus, most manufacturers expect recovery to be gradual and to be deferred until the first half of 2002; some in technology-dependent sectors anticipate further delay.

Makers of consumer goods are anxious about the upcoming holiday season. They say that consumers appear hesitant to make discretionary purchases and that retailers are ordering very sparingly

in order to avoid the costs associated with excess stocks. A manufacturer of consumer instruments is responding to these conditions by not adding any temporary production help to gear up for its heaviest quarter of the year. However, one firm supplying computer printer components is encouraged by signs of fairly robust customer projections for the holidays, following weak sales for the year to date.

Makers of capital goods continue to report weakness. They cite a lack of purchases by the semiconductor, steel, domestic automotive, and telecommunications industries in particular and a general tightness in capital budgets because of economic uncertainty and a desire to conserve cash. New orders relate mostly to sectors that are relatively strong - such as biotech, pharmaceuticals, aerospace, and oil and gas - and to customers developing improved products. However, contacts in semiconductor-related industries cite a lack of successful new technology products as a major obstacle to their recovery.

Respondents say their selling prices and materials costs generally are flat or down. They cite downward pricing pressures as a result of intensified use of Internet-based auctions, competition from imports, and customer-initiated contract renegotiations. Energy costs are said to be higher than a year ago but stabilizing or coming down. Manufacturers continue to keep a tight lid on labor and capital costs, although in some cases they feel they have already made appropriate reductions. About three-quarters of contacts see employment holding at current levels through the end of the year, while only one-quarter anticipate layoffs or furloughs. About one-half of respondents have intensified efforts to reduce capital expenditures since last contacted for the Beige Book.

Software and Information Technology Services

Most software and IT respondents report some improvement in demand for their products in the current quarter. For some firms, demand is leveling after a few quarters of softening; for others, demand slowed less rapidly in the most recent quarter. Respondents' opinions are mixed on whether sales have hit bottom or still have a few quarters before they level off. A few contacts report that products targeted for middle to small firms are performing much better than those for large corporations. Respondents who report rising demand generally say their results reflect specific client industries or product initiatives, not

the economy as a whole. Although some contacts are downbeat about the near term, almost all feel that the long-term outlook is positive.

Software and IT respondents report level employment and capital spending. Most do not expect to reduce employment further in the near future. They are waiting for improvements in demand before going ahead with expansion plans.

Temporary Employment

Most contacts in the temporary employment industry continue to report very slow business. Overall revenues in this or the previous quarter are said to have dropped 30 to 40 percent from a year ago, with more severe declines for permanent placements. Contacts indicate that demand fell more steeply between February and May than since June. Most respondents say demand has been flat since June, but some firms that provide temporary office support and light industrial workers report a pickup.

In high tech sectors such as IT, manufacturing, engineering, and telecom, large layoffs and hiring freezes continue; very few clients are hiring tech workers. Office support and accounting are doing better than high tech, but most contacts report negative growth in these areas as well. Many contacts report increasing pressure from clients to lower prices and mark-ups, and hourly rates for IT workers are down. Finding workers is not a problem; contacts are flooded with resumes. But some clients are demanding more specific skills and requirements, making matches more difficult. Many contacts are cutting costs aggressively and some have laid off up to 25 percent of their own staff, especially recruiters.

Commercial Real Estate

Commercial real estate markets continue to slow. Contacts report that the most desirable office locations, such as downtown Boston and Portland, are still faring relatively well; vacancy rates are higher than a year ago, but at reasonable levels. However, suburban Boston and Cambridge vacancy rates have increased considerably, driven in part by the contraction of both large and small high-tech firms. The acquisition market is in a wait-and-see period, with many customers on the sidelines. Most contacts expect commercial markets to remain slow until at least second quarter 2002.

SECOND DISTRICT--NEW YORK

The District's economy has shown further signs of weakening since the last report, despite some apparent stabilization in the manufacturing sector. With energy costs subsiding, overall input price pressures have eased, and increased competition has kept downward pressure on selling prices. Labor markets have been fairly stable since the last report. Most retailers say that sales remained sluggish in August, with the recent tax rebates reportedly having little effect on demand; retail inventories are said to be at satisfactory levels, while selling prices are flat to down slightly. Consumer confidence fell among residents of downstate New York in August, but rose slightly in upstate areas.

While home construction and prices are still described as buoyant, there have been signs of softening in the New York City area. Office rental markets in and around New York City remain sluggish, but sales and construction of office buildings remain fairly strong. Manhattan hotel room rates slipped to a three-year low in August and were down 7 percent from a year earlier. Finally, bankers report weakening loan demand, tightening credit standards on all types of loans, and a significant upturn in delinquencies on home mortgages.

Consumer Spending

Retailers indicate that sales were on or below plan in August, but not as weak as in July, on balance. Same-store sales were generally little changed from a year earlier, with discounters continuing to fare somewhat better than department stores. In particular, sales of home-improvement and other household goods were described as weak, though energy-saving products continued to sell well. Apparel sales were mixed—back-to-school merchandise for juniors performed fairly well, but men's clothing sold poorly. A few contacts indicate that consumers seem to be increasingly price-conscious.

Most retail contacts believe that the recent tax rebates have not had a significant effect on spending; one estimates a half a percentage point boost. Contacts generally continue to describe current inventory levels as satisfactory. Most major chains are now planning for little or no increase in

Christmas season sales, from last year's levels. Selling prices and merchandise costs were said to be flat to down modestly.

According to Siena College's latest monthly survey of New York State residents, consumer confidence in the New York City area fell in August to the lowest level in the survey's 2½ year history. In upstate New York, however, confidence edged up in August for the second consecutive month.

Construction and Real Estate

Although residential construction activity has remained brisk thus far in the third quarter, housing markets in and around New York City have shown signs of softening. Both multi-family and single family housing permits rose in July, on a seasonally-adjusted basis, and were higher than a year earlier. More recently, homebuilders in New Jersey reported that they are continuing to build wherever they can find available land, due to a persistent backlog of orders. However, an industry expert notes that there has been some softening in demand at the high end of the market, in the form of buyers adding fewer and less costly upgrades and enhancements.

The market for existing homes has been mixed in recent weeks, with some softening reported in and around New York City, but continued brisk activity in upstate New York. Realtors in the Albany and Rochester areas report that home sales were robust in August. In contrast, contacts in both New York City and northern New Jersey report that while home prices are still well above year-ago levels, a number of sellers have reduced their asking prices in recent weeks. Similarly, New York City's apartment market has shown signs of cooling. Manhattan residential rents, which had risen sharply in recent years, leveled off in the first half of 2001. Rents in the outer boroughs also appear to have stabilized and vacancy rates have reportedly edged up. Manhattan's co-op and condo market, which had remained fairly strong through mid-year, has taken on a softer tone in recent weeks, according to a leading real estate firm—unit sales in August were roughly on par with a year ago, but the average selling price was down moderately.

Despite continued weakness in commercial real estate markets, nonresidential construction activity has been brisk. Manhattan's office market appears to have stabilized somewhat since mid-year, as both rents and availability rates were little changed in July. However, leasing activity was reported to be down an estimated 70 percent from a year earlier; while dot-coms were the dominant lessees last year, most demand this year has come from the media, financial and legal services industries. Despite the dramatic slackening in the office rental market, brokers report that selling prices for office buildings have remained strong, helped by a favorable debt market. Office construction remains fairly brisk, particularly in northern New Jersey, where the volume of new construction is reported to be up 80 percent from a year ago. In addition, overall construction activity is expected to be buoyed, for some time, by the large volume of long-term infrastructure projects currently in progress across New York State and New Jersey—particularly schools, highways, and rail projects.

Other Business Activity

A major New York City employment agency says that the local job market has not changed much since the last report—real estate and law firms continue to hire briskly, while banks are recruiting very selectively. This contact reports that wages and salaries are holding steady, but asserts that many workers, especially on Wall Street, will be “shocked” by the magnitude of bonus reductions at year-end.

Manhattan's hotel occupancy rate (seasonally-adjusted), held steady at 80 percent in July, but was down almost 10 points from a year earlier. This falling occupancy rate, in part, reflects a 7 percent increase in the number of hotel rooms since the beginning of the year; current construction will add another 5 percent to the existing stock. Reflecting the changing market conditions, the average room rate slipped to a three-year low and is down 7 percent over the past year.

New York State manufacturers continue to note that intense competition, largely from overseas, is exerting downward pressure on selling prices. However, they expressed somewhat less pessimism about the general business climate in August and early September than in July. Similarly, purchasing

managers in both the Buffalo and New York City areas report little change in manufacturing activity in August, along with widespread declines in input prices—notably energy.

Financial Developments

The overall demand for loans fell over the past two months, according to bankers surveyed at small to medium-sized Second District banks. Demand was stable for nonresidential mortgages and commercial and industrial loans but weaker for consumer loans and residential mortgages. However, refinancing activity increased.

On the supply side, tighter credit standards were reported for all major loan categories. Most notably, more than 30 percent of bankers say they tightened standards for commercial and industrial loans and nonresidential mortgages, while none reported an easing. Widespread declines were reported on all categories of loan rates, as well as deposit rates. Delinquency rates on consumer loans and nonresidential mortgages were little changed; however, increased delinquencies were reported on commercial and industrial loans and, notably, on residential mortgages. In fact, 21 percent of those surveyed report rising delinquencies on home mortgages—the highest proportion since January 1997.

THIRD DISTRICT – PHILADELPHIA

Business activity in the region remained subdued in August. Manufacturers reported declines in shipments and orders in August compared with July. Retail sales rose slightly for the back-to-school shopping period, but the underlying trend in consumer spending in the region showed no signs of picking up. Motor vehicle sales slipped in August. Bank loan volumes rose slightly in August, with gains in most major credit categories. Commercial real estate markets eased somewhat. Residential real estate markets were generally firm. Home sales have been steady, although off from last year's pace, and price appreciation for existing homes continues but appears to be moderating.

Looking ahead, businesses in the District have mixed views. Manufacturers forecast increases in orders and shipments during the next six months. Retailers, however, anticipate slower sales in the last quarter of this year. Bank credit officers expect continued slow growth in lending. Real estate contacts expect some further softening in commercial markets. Residential real estate agents believe home sales will falter if the regional economy slows further.

MANUFACTURING

Third District manufacturers reported continuing declines in activity in August. Orders and shipments were down compared with July in nearly all the major manufacturing sectors in the region. A few firms producing fabricated metal products, plastic products, and food products reported month-over-month increases in orders. In general, the region's manufacturers trimmed inventories during August, and they plan further reductions during the next six months. Third District manufacturers continue to report intense competition from foreign firms. Local makers of lumber and paper products noted increasing sales in domestic markets by producers from other countries. Local manufacturers of metals, industrial machinery, and industrial materials indicated that competition from companies worldwide, and from Asia especially, has been growing.

Despite current weakness in the manufacturing sector, local companies expect conditions to improve during the next six months. More than half of the firms polled in August forecast increases in orders and shipments. They expect to extend working hours, although they do not plan to increase employment. Area firms have been trimming inventories, and they plan to make further reductions in the next six months. Capital spending plans at area firms remain limited, overall, although some firms within the chemicals, plastics, and instrumentation sectors have scheduled higher outlays for new plant and equipment during the next six months.

RETAIL

Nearly all the Third District retailers contacted for the report said sales picked up for the back-to-school shopping period, although the increase was below their expectations, overall. Sales of women's apparel rose, and a tax-free shopping period for personal computers in Pennsylvania boosted sales of computers and peripheral equipment. But in general, merchants indicated that sales in late August and early September did not rise above the lackluster trend that has characterized most of the year so far.

Local store executives said they were reviewing their sales plans for the balance of the year for possible downward revision. Several merchants said they anticipate no increase in sales for the last quarter of this year compared with the same period last year. Although most retailers indicated that their current inventory levels were not troublesome, many are considering reducing orders for merchandise to be delivered during the remaining months of the year.

Overall sales of cars and light trucks have slowed in recent weeks, although some import dealers have posted gains. On balance, dealer inventories have increased, but most of the dealers surveyed said the increase was slight. Manufacturers' incentives continue to support a relatively high sales rate, but dealers are becoming increasingly concerned that consumer confidence is weakening, portending a fall in demand.

FINANCE

Lending at major Third District banks rose slightly in August. There were small gains in most credit categories. Residential real estate lending increased for both refinancings and purchase mortgages. Credit card lending has been moving up, but there has been a recent easing in other types of consumer loans. Business lending has increased marginally. Some banks have experienced slight increases in nonperforming loans, both personal and business, but credit officers at these banks said the increase was well within anticipated bounds.

Looking ahead, commercial bankers in the Third District generally expect continued slow growth in lending. They anticipate some easing in the growth rate of real estate loans, but steady gains in personal and business loans. Lending officers expect business activity and credit needs to increase slowly in most of the region's industries, except among computer manufacturing and information technology service companies.

REAL ESTATE AND CONSTRUCTION

Third District commercial real estate markets have softened somewhat. The vacancy rate for office buildings has risen by one to two percentage points in most areas since spring. In the Philadelphia central business district, the vacancy rate has moved above 9 percent, according to recent estimates by commercial real estate firms. In suburban markets, the rate has risen to an average of 12 percent. Lack of office construction in the Philadelphia central business district has kept the vacancy rate there relatively low. In suburban markets, the amount of new space that has been put on the market recently has exceeded demand, and more space is expected to become available during the rest of this year and next. Rental rates have increased in the Philadelphia central business district and have been steady in the suburbs. Some commercial real estate agents expect rents to decline during the balance of the year in both the central business district and the suburbs. Demand for industrial space has eased. The slowdown in Internet merchandising has reduced the demand for warehouse and distribution space in particular. The industrial vacancy rate in the region has moved up, and rents have been generally flat. Construction of industrial buildings continues, but the amount of new space under construction has been declining.

Residential real estate agents generally indicated that sales of existing homes have been running at a steady rate recently, albeit below the rate set last year at this time. Price appreciation continues for existing homes but appears to have moderated somewhat over the summer. Homebuilders reported that sales were steady during July and August at around the same rate as during the same months last year. Prices have been rising significantly for new homes. Real estate agents and builders indicated that relatively low mortgage interest rates and generally healthy financial positions among consumers are supporting demand for homes, although uncertainty about general economic conditions is keeping some prospective buyers out of the market. Residential real estate contacts say sales could slow sharply if the region's economy weakens further.

FOURTH DISTRICT - CLEVELAND

General Business Conditions and Labor Markets

The manufacturing sector in the Fourth District is weak. Poor sales during the first two quarters have caused some plant closings, hiring freezes, and layoffs. On the other hand, consumer spending appears to have increased slightly in August and September from the low levels of July. Prices for producer goods and retail products remain flat, as do wages.

Demand for temporary workers has increased slightly from the very low levels of early summer. While demand decreased for highly skilled positions, it remains somewhat strong for warehouse workers, light manufacturing, and office support, especially in legal offices. Our contacts reported that many positions previously filled by temporary agencies have disappeared because of layoffs and plant closings. Agencies reported no trouble in finding qualified applicants (and in the last month, they experienced a large increase in the supply of applicants) and generally no pressure to increase wages. The agencies expect some increase in the demand for workers by the new fiscal year in January.

Our union contacts reported negotiated wage increases of three to four percent for new contracts. In the steel industry, previously negotiated wage increases were reduced in exchange for new job-security provisions. All of our union contacts reported that employers are reluctant to hire new workers, and some have negotiated agreements that allow the employer to reduce the number of employees through attrition.

Construction

Commercial builders reported that construction throughout the District is stagnant, at levels of activity considerably lower than those of a year ago. This is true across all categories of commercial building. In order to keep skilled employees on their payrolls, many builders have accepted less profitable or less traditional types of projects more than they have in the past.

District homebuilders noted a stable residential market. Although sales of new homes remain flat, home prices have been reduced. There are fewer backlogs of work,

and most of our contacts reported that all of their subcontractors are producing their products on time.

Prices for materials remain generally flat. Employers have been able to hire most trades people far more quickly than last year at this time. The only trades reported to be in short supply in some regions are masons, framers, and roofers.

Industrial Activity

Orders for steel stabilized at low levels in July and August. Demand for stainless steel remains weak. Prices for steel also stopped falling during the same months. Capacity at steel mills remains at about 75 percent; optimal capacity utilization is 92 percent to 95 percent. Most mills and furnaces reported operating for only five days a week, and layoffs of 5 percent to 10 percent were reported at many plants in the District.

Demand for fabricated metal products remains very low. Sales have decreased 20 percent since last year, and bankruptcy auctions are up 25 percent. Many of the firms in this industry are experiencing large layoffs. On the other hand, some of our contacts reported a recent small increase in orders and anticipate that the difficult conditions may improve over the next year. Rubber and plastics manufacturers are experiencing much smaller demand, especially in the automobile sector, which is seeing declines of up to 30 percent in sales from last year. Inventories in rubber and plastics are down; some manufacturers would like to achieve even lower inventory levels. Sales of chemicals are sharply lower than in the spring.

Transportation and shipping companies across the District reported the same level of activity in July and August as in the latter half of the second quarter. Some items, notably steel, dropped further from the already depressed levels of early summer. Other items, such as electronics and construction goods, are shipping at the weak levels of the beginning of the summer, while retail goods are being shipped at higher levels. A recent spike in fuel charges during the last few weeks, due to a refinery fire in Chicago, has not resulted in increased shipping prices. As in other sectors of the economy, firms involved in transportation and shipping indicated that it is much easier than last year to secure qualified workers.

Consumer Spending

Retail sales are generally reported to be flat, with several area stores reporting a small increase. Large shopping centers seem to be doing better than other stores, and items that are selling well include summer clothes and home decorations. All contacts expect sales to remain stable over September and October and do not expect substantial increases throughout the rest of the year.

Automobile dealers reported that sales of new cars in August were slower than in a fairly strong July. Sales remain considerably lower than at the same time last year. The decrease is concentrated among domestic brands and luxury cars. Dealers attributed the softer sales to consumer fears of a declining economy. They also reported strong used car sales as consumers shift from the new car market. Inventories of new autos are being held at lower levels than last year because many dealers do not expect sales to increase until the spring of 2002. The demand for boats has declined to about four-fifths of last year's level. Sales have softened over the last 6-8 weeks, particularly for the large luxury fiberglass craft.

Agriculture

Dry weather in the northern part of the District has left farmers expecting to harvest only 50 percent to 75 percent of their average annual corn yield and 70 percent to 90 percent of their average annual soybean yield. Farmers in the southern part of the District reported far better conditions and anticipate an above-average harvest. Livestock farmers reported that business is excellent, and prices for beef are significantly higher than last year.

Banking and Finance

Lending activity in the District is mixed for commercial loans, with some banks reporting small increases and some small decreases. On the other hand, our contacts reported slight increases in consumer loans in August. There is a large increase in refinancing, which our sources attributed to the recent rate cuts and, to a lesser extent, to a consolidation of credit card debt. Our contacts also reported an increase in loan delinquencies and a slight decline in credit quality. On the other hand, the spread

between lending and deposit rates has risen slightly. This has been attributed to lower short-term and deposit interest rates.

FIFTH DISTRICT—RICHMOND

Overview: The Fifth District economy advanced at a modest pace in August and early September, as firmer manufacturing activity accompanied weaker retail sales. The manufacturing sector showed its first evidence of expansion since last fall: shipments rose and capacity utilization stabilized. In contrast, retail sales generally declined in August, though the degree of contraction was less than in July, and automobile sales firmed. Demand for services continued to grow, but there was added concern about future prospects. Housing sales remained at a generally high level in August and early September, while the construction and leasing of commercial properties weakened somewhat. In labor markets, wage growth picked up at retail and manufacturing firms, but eased at service providers. Price increases remained modest at factories and services firms. Scattered rainfall improved crop development in most areas of the District, except South Carolina, where drought conditions persisted.

Retail: District retailers reported somewhat lower sales in August, although declines were not as sharp as in July. Contacts said that layoffs at major employers continued to be a drag on sales growth. Sales of big-ticket items, such as appliances, were generally lower, as was shopper traffic. A large chain retailer in the metro Washington, D.C., area said that while sales were "better than expected" in August, they were weak over the Labor Day weekend. Automobile dealers in Richmond, Va., and the eastern panhandle of West Virginia, however, reported stronger sales in recent weeks. Reflecting the lackluster tone of retail, employment in the sector was flat and retailers said that price increases were modest.

Services: Services businesses reported moderately higher revenues in August but flat employment. A number of contacts also noted fewer "contracts in the pipeline" and expressed concern about future business prospects. Travel agents reported a slight increase in bookings. However, a manager at a financial services firm in Baltimore, Md., said that the brokerage side of his business was slow, and added that his clients were "outright worried" about the economy. In addition, a business consultant in Charlotte, N.C., reported having more difficulty collecting fees from financially-strapped clients. Employment and overall wages in the sector were little changed, but respondents at a number of healthcare facilities said that they had increased wage offers to nurses and technology workers, who remained in short supply.

Manufacturing: The manufacturing sector showed nascent signs of expansion in August, after almost a year of general decline. Shipments grew at a moderate pace during the month and new orders stabilized. Contacts in the food, printing, plastics, and primary metals industries reported

notably stronger manufacturing activity. Several producers of electrical equipment also told us that shipments had started to pick up and a manager at a food processing plant reported that his company had lengthened the workweek from 5 to 6 days. Some industries, however, still struggled. A furniture manufacturer in North Carolina remarked that layoffs and plant closings continued and he believed that the industry was in “the worst recession since 1981, maybe 1973.” Prices in the manufacturing sector were little changed.

Finance: District loan officers reported that the pace of lending activity was somewhat slower in the weeks since our last report. Several commercial lenders said that generally sluggish economic conditions had trimmed the demand for loans and few expected a rebound any time soon. A Richmond, Va., banker commented that she was still seeing “a lot of negative earnings on borrowers’ financial statements,” and suggested that the economic slowdown “had not hit bottom yet.” A number of commercial bankers also noted tighter credit conditions—a Greenville, S.C., lender said that credit was as tight as he had seen in the last ten years. Residential mortgage lending was boosted by strong refinance activity, but growth in new loans was modest. Several loan officers said they had increased marketing efforts in an attempt to bolster lending. Residential mortgage lenders were generally upbeat about future prospects—a Charleston, S.C., banker noted that while lending in August was slow, he had been “real busy” in early September and expected the pickup in activity to continue into the fall.

Real Estate: Residential realtors and homebuilders reported little growth in home sales in August and early September but they said that both sales and construction activity remained at a high level. Lower mortgage rates stimulated home sales in many areas of the District, even though some realtors commented that stock market declines had squelched demand for homes in the upper price ranges. On the bright side, a realtor in Richmond, Va., said that his firm was having a “phenomenal” run—sales doubled in August from a year ago, in part because of lower mortgage rates. And a Greensboro, N.C., realtor said that sales in August were the best he had ever seen. But several realtors stated that the upper-end home market had slowed, leaving them with excess inventory of higher-priced homes. In Charlotte, N.C., the market for homes selling in excess of \$1 million was said to be “struggling,” while a builder in North Carolina characterized sales in the upper-price market segments as “almost non-existent.” A number of builders reported substantially higher costs of lumber and drywall.

Commercial realtors reported generally weaker leasing activity, but noted that the pace of the decline had slowed somewhat in recent weeks. The industrial sector experienced a moderate decline

in activity, while the construction and leasing of retail properties remained flat. A Raleigh, N.C., realtor reported that he had noticed a decrease in small specialty shops, but the “usual suspects” (grocery and video stores) were still going strong. Vacancies of Class A office space generally stabilized, except in areas with high concentrations of high-tech firms. Commercial office rents were generally unchanged, but concessions by landlords, such as a month’s free rent, increased markedly. A Columbia, S.C., realtor reported seeing concessions in the office and industrial sectors for the first time in years.

Tourism: Tourism was mixed since our last report. Hoteliers in Virginia Beach, Va., and Myrtle Beach, S.C., reported that bookings for the Labor Day weekend were somewhat stronger than last year. However, a contact on the Outer Banks of North Carolina noted that her business was somewhat weaker compared to a year ago and that some hoteliers lowered room rates in mid-August to encourage bookings for the Labor Day weekend. She attributed the weakness to a slower economy and diminished consumer confidence. In contrast, a manager of a resort in the mountains of Virginia said that occupancy rates had increased in recent weeks and advanced reservations for the upcoming ski season had been exceptionally strong.

Temporary Employment: Contacts at temporary employment agencies reported that the demand for workers had been mixed in recent weeks. A manager in Hagerstown, Md., and a contact in Rockville, Md., reported that clients’ interest in workers was “very weak” and the agency had more difficulty securing new clients. A Richmond, Va., agent, however, said that the economy had picked up recently, and she expected demand for temporary workers to strengthen. A manager in Raleigh, N.C., also expected her clients to need more workers in coming months because many small and medium-sized businesses were “through with their holding pattern” and ready to start new projects and hire new staff.

Agriculture: Scattered showers and thunderstorms in late August and early September boosted soil moisture levels and aided crops in many parts of the District. Drought stricken South Carolina continued to suffer, and cotton, peanut, and soybean growth and development was delayed. Corn harvesting was behind schedule in South Carolina and Maryland, but was ahead of schedule in North Carolina and Virginia. District farmers made good progress in harvesting tobacco, peaches, and apples. Wheat planting was well underway in West Virginia, and farmers in North Carolina and Virginia were making headway sowing fall grains.

SIXTH DISTRICT – ATLANTA

Summary: Sluggish growth characterized economic activity in the Sixth District in late summer, according to business contacts. Merchants' sales improved modestly from earlier in the summer, but inventories were high. Auto sales remained lackluster in spite of incentives. Single-family construction and sales were near year-ago levels, but commercial real estate markets were sluggish. Reports from the factory sector were mostly negative, with new layoffs and weaker new orders. Business and leisure travel weakened. Contacts reported few instances of rising price pressures.

Consumer Spending: According to District retailers, sales growth in August was better than the modest results posted in July. More than two-thirds of retailers contacted said that recent sales had met or exceeded their expectations; however, inventories were described as high. Several retailers noted that heavy discounting and tax rebates helped recent sales. Discount retailers continued to fare the best. Looking ahead, most retailers anticipate holiday sales growth to be modest at best, and some noted that they are stocking up on inexpensive gift items and value-priced items.

Manufacturer incentives and lower interest rates have not yet appreciably stimulated District car sales. Through July, growth in new vehicle registrations was well below the national pace in all District states except Florida. Dealers selling domestic models reported that August car sales were off from year-ago levels.

Construction: Single-family construction remained near last year's levels in July and August, but sales of new homes weakened slightly in August compared with July's pace. Reports from realtors indicated that home sales around the District closely mirrored year-ago levels. The strongest reports again came from Florida, with both low-end and high-end home

sales described as particularly strong in south Florida. Inventory remained in short supply in Florida markets but was generally balanced across the rest of the District. In Atlanta, demand has been strong at the low end of the market while expensive properties have been difficult to sell. Across the District, the pace of home sales is expected to remain fairly constant through the rest of the year, and residential construction is expected to slow somewhat in the fourth quarter.

Most commercial real estate markets continued to weaken in August. Sublease space in office and industrial markets was still entering the market at a brisk pace, with widespread use of incentives. Office, industrial and retail construction and expansions have slowed significantly from last year's strong pace and are expected to remain subdued through year-end.

Manufacturing: Reports from the factory sector were mostly negative in August. Large textile mills continued to close, and high-tech manufacturing firms continued to downsize operations. The region's paper industry remained weak, and the metals industry posted declines in new orders and shipments. One factory executive reported that most of the local industry in his area was taking a "wait and see" attitude concerning capital investment. One notable exception is the recent surge in construction of electricity-generating plants in the District. Commitments for orders of military planes boosted the District's aerospace industry, and some auto plants in the District have been gearing up for new models.

Tourism and Business Travel: Business travel remained weak in the District in late summer, and reports from Florida's leisure travel industry noted slowing from last year's record-breaking numbers. Resort tax collections and airport traffic in central Florida were down from last year, and theme parks reported a slump in attendance. Reduced convention attendance and business travel negatively affected the hospitality industry across the District. A large casino in Louisiana laid off over 100 workers, reportedly in part because of the weaker national economy,

and gaming revenues at casinos along the Mississippi Gulf Coast continued to post lackluster growth.

Financial: Overall loan growth was flat at most banks in the District in August. Residential lending—particularly mortgage refinancing—rose in parts of the District, but auto installment lending weakened. The business sector remained on the sidelines, with credit demand by large corporations particularly low. Lending for new commercial construction remained slow. Credit quality was stable, with problems remaining largely confined to the leveraged syndicated market.

Wages and Prices: Wage pressures remained subdued, according to most reports, and firms continued to cut workers' hours and eliminate temporary workers during August. Firms, particularly technology companies, reported being more selective in hiring. One contact noted that it now takes up to three months to find a job in the technology sector. District contacts again cited only a few instances of escalating prices, and most noted significant energy price reductions from recent highs. Health care costs and liability insurance premiums continued to increase at a substantial pace.

Agriculture: Through early August, cotton, soybean and peanut crops were rated from good to excellent, with favorable rainfall and warm weather conditions. However, cotton crops were harmed by heavy rains in early September. Regional contacts report that poultry production increased and broiler exports are up sharply this year, led by higher demand from Russia and Eastern Europe.

SEVENTH DISTRICT—CHICAGO

Summary. Economic activity in the Seventh District remained sluggish through August and early September. Consumer spending softened somewhat further, and contacts' reports did not note any specific boost from federal income tax rebates. Construction and real estate markets were mixed, as residential activity remained comparatively strong, while commercial activity softened further. Manufacturing activity remained very weak, but did not appear to deteriorate. Demand for business loans was again soft, while low mortgage rates continued to boost household lending. Demand for labor remained relatively soft. Upward pressure on retail prices remained subdued, but contacts continued to express concern over increasing health and liability insurance costs. Farmland values increased modestly in the second quarter, but many farmers were faced with deteriorating crop conditions and low crop prices.

Consumer spending. Consumer spending softened somewhat further through August, according to most contacts. Mirroring a national trend, discounters continued to outperform general merchandisers. Strong back-to-school and electronics sales helped most discounters exceed their expectations. With few exceptions, however, general merchandisers reported that sales results fell below plan, and showed little, if any, year-over-year increase. Inventories were generally said to be in good shape, but merchants reported slightly higher-than-normal promotional activities and discounts. One contact reported that casual dining sales were strong through most of August, but "fell off the table" in the last week of the month and over the Labor Day weekend; and the drop was evident in each of the company's dining categories, from low-end to high-end. A large District auto group indicated that showroom traffic was down in August and sales were off as well. Sales of foreign nameplates again were better than those of domestic nameplates, another trend that mirrored national results. This contact also noted that out-the-door new vehicle prices showed year-over-year decreases, and late model used vehicle prices were said to be "taking a beating" as well. Spending on leisure travel in the region remained relatively strong through July, though not strong enough to offset the decline in business travel. There were virtually no signs of intensifying upward price pressures at the retail

level. In fact, when prices were mentioned in contacts' reports, more often than not prices were moving downward.

Construction/real estate. Overall construction and real estate activity was again mixed in August. Conditions in the residential market were similar to our last report, as builders and realtors continued to report strong demand and "healthy" sales levels. Nearly all contacts, however, indicated that softness persisted at the high end of the housing market. On the commercial side, office vacancy rates were still trending up in most markets. The amount of sublease space being marketed also continued to rise, according to contacts, albeit at a more modest pace. Demand for new space remained very weak, and the combination of soft demand and increasing availability continued to put downward pressure on office rental rates. One contact surmised that many decisionmakers were waiting for rental rates to bottom before signing a new lease or sublease. Retail development was again strong, but contacts suggested projects in the pipeline were drying up, indicating that retail construction activity may slow in 2002. Decreasing business travel led to increasing hotel vacancy rates in most metro areas which, in turn, was putting downward pressure on room rates.

Manufacturing. Manufacturing activity was weak again in August, but contacts mostly suggested that conditions had not deteriorated further. Light vehicle sales nationwide were somewhat softer in August, but "nothing overly dramatic" according to one contact. Inventories were generally in good shape but, with softer sales, industry analysts were expecting light vehicle production to be cut back slightly in the fourth quarter. Conditions in the District's steel industry were said to be improving somewhat, partly the result of plant shutdowns in other regions. (The shuttering of a large steel producing facility in Ohio enabled some of the region's producers to gain market share.) A similar scenario played out in the gypsum wallboard industry. One large national producer idled nearly 45 percent of its capacity. Reduced supplies, higher capacity utilization, and continued strong demand from the housing market allowed one District wallboard producer to push through some fairly significant price increases during the summer. Conditions in the heavy machinery and heavy truck sectors changed little, as new orders and production in both industries remained at or near recessionary levels. The absence of further deterioration in the manufacturing environment was encouraging to many contacts. After

several months of slowing, a large tool manufacturer suggested that steady, albeit unspectacular, activity was an important “positive” sign. In addition, a few contacts noted that demand for paper and corrugated shipping containers picked up.

Banking/finance. Overall lending activity was mixed in August, as business loan demand remained soft while household demand was again relatively strong. Similar to our last report, commercial lending activity generally remained soft. A few reports were mixed, however, with bankers in some areas noting increases in business loan activity while others suggested decreases. Standards and terms for business loans were relatively unchanged, although one large bank did report that credit was “getting easier” for all but large corporate borrowers. Some contacts noted that business credit quality eroded a little further in August, with much of the deterioration concentrated in manufacturing-related loans. Most contacts were confident, however, that banks had adequate capital and reserves to cover any cyclical losses they may incur. Consumer borrowing remained strong in August, again led by demand for mortgage loans. Low interest rates on fixed-rate mortgages continued to spur strong refinance activity in most markets, and new originations were also said to be “holding up” at high levels. Home equity loans and lines of credit were rising strongly in some markets as well. A contact with one large bank, however, reported that the bank was pulling back on home equity products out of concern that exceptional home price appreciation in recent years may have left the housing market overvalued.

Labor markets. Demand for workers in the District remained relatively soft in August, although reports of further softening and significant layoffs became less frequent. Claims for unemployment insurance through August remained about 40 percent higher than at the same time last year (down from nearly 80 percent in April), and higher continuing claims suggest that idled workers were finding it more difficult to find suitable employment. In sharp contrast to earlier in the year, however, the data suggested that the upward trend was no longer being driven by the most heavily industrialized states in the District. In fact, there were scattered reports of some manufacturing firms calling back a fraction of their furloughed workers. Contacts with staffing agencies indicated that new orders for workers were mixed. Some clients were said to be letting temporary workers go early, while others were keeping them longer than expected.

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There were more widespread reports that employers were canceling or significantly curtailing fall recruiting activities at college campuses. While wage pressures eased further, contacts continued to express concern over the rising costs of health insurance. As competition for labor eased in recent months, more employers were said to be considering increasing workers' contributions to help offset rising health insurance premiums.

Agriculture. Farmland values in the District increased 1 percent (on average) from the first quarter to the second and were up 5 percent from a year ago, continuing the pattern of change in the previous four quarters. Credit conditions in the industry were reported to be generally acceptable, a condition that bankers noted was heavily dependent on subsidy payments. Crop conditions deteriorated in District states from early July through August, and on the whole were considerably less favorable than a year ago. Field crop prices at the farm-gate continued to reflect "weather-market" volatility and remained in the low end of the market price range observed during the past decade. At the same time, financially-stressed dairy farmers have benefited from a continued sharp runup in milk prices that began in the first quarter.

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EIGHTH DISTRICT – ST. LOUIS

Summary

Economic activity in the District has continued to slow, particularly in the manufacturing sector and in those industries that serve the manufacturing sector. Retail sales were down in July and August, with sales in both months falling short of retailers' expectations. Sales of automobiles are down from a year ago, and there has been a shift toward used vehicles. Overall, retailers and auto dealers have mixed expectations for the immediate future, as the optimistic ones are roughly as numerous as the pessimistic ones. The residential real estate sector remains the brightest spot of the District economy, as sales volume and prices continue to rise in most of the District. In contrast, commercial real estate markets have softened. Total loans by small and mid-sized banks are down slightly, and there is a trend toward stricter loan standards. Crops appear to be in good-to-excellent condition, with near record-high yields expected in some areas for cotton, corn, and rice.

Consumer Spending

Contacts report that consumer spending in July and August was down slightly, and that sales in August were weaker than in July. Less than one fifth of contacts reported that sales for the period were above projections. Back-to-school items, including junior's and children's apparel, were strong sellers in August. Basic items such as paper and commodities, as well as "budget stretchers" such as rice and pasta, also have been moving well. "Non-essentials" such as home and apparel accessories, furniture, and jewelry have been moving more slowly. Most retailers report that inventories are near desired levels. Expectations for the fall are mixed: one third of the contacts are optimistic, the remainder expect a downward or flat trend.

Auto dealers in the District report that sales were below average for July and August, and that August's sales were noticeably worse than July's. Most note a shift from new cars to slightly used cars with smaller engines. A few contacts, however, report strong growth in sales of high-end vehicles. Almost all note that higher rebates have helped sales, but not as much as some had hoped. Most contacts

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are seeing low inventories, especially of used, low-end vehicles. Expectations are divided:

Approximately half of the contacts expect growth while the other half are pessimistic.

Manufacturing and Other Business Activity

The level of activity in the District manufacturing sector, on balance, has been stagnant. Producers of clothing and apparel, automobiles, and technological products are facing layoffs and cutbacks in some parts of the District. Some bright spots, however, have been noted: Food processing and metal parts plants will be expanding or moving to the District in the next year, and at least one District furniture plant is planning to hire back some employees and expand production.

Service industries are posting slower growth than last year. As manufacturing has slowed, the trucking industry has seen less freight, and package handling companies and airlines have seen decreases in volume from a year ago. As a consequence, these industries have been reducing their workforce and employee hours. Performance in the technology and finance sectors has been mixed, with some companies cutting back and others expanding.

Despite the general slowdown, employers in much of the District are still having difficulty filling positions with qualified workers. Some loosening, however, has been noted in the construction industry.

Real Estate and Construction

The real estate industry continues to be strong to very strong in much of the District, particularly in St. Louis, Memphis, and Little Rock, where year-to-date unit sales, volume sales, and average prices all are higher than a year ago. Exceptions to this are northern Mississippi, where sales of new and existing homes are at their weakest levels in several years, and Louisville, which contacts describe as a buyer's market, although demand for homes in the range of \$100,000 to \$250,000 is still strong. An oversupply of commercial and industrial space still exists in Louisville and St. Louis, where vacancies and sub-leasing have become more commonplace.

Residential construction across most of the District has slowed a bit, with monthly building permits down in July. However, over half of the District's metropolitan areas show year-to-date levels greater than they were a year ago. Despite a lower number of building permits in July, reports from

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Memphis show an increase in the total valuation of these new permits. Private construction is down from a year ago in western Kentucky, but government-sponsored construction remains strong.

Banking and Finance

Total loans outstanding at a sample of small and mid-sized District banks were down by 1.4 percent between early June and early August. This stemmed from weak real estate loans, which were down by 1.8 percent over the period. At the same time, consumer loans fell by a modest 0.9 percent, while commercial and industrial (C&I) loans remained essentially unchanged. Total deposits at these banks were down by less than 1 percent. Reports from the Memphis area indicate an increase in the numbers of loan delinquencies and bankruptcies.

In a survey of District senior loan officers, about 20 percent of respondents indicate that their banks have tightened credit standards on C&I loans to large and mid-sized firms; nearly 40 percent of respondents indicate tighter standards on C&I loans to small firms. All respondents indicate tighter standards for technology companies. Standards for real estate loans, consumer loans and credit cards are essentially unchanged.

Agriculture and Natural Resources

Increased rainfall and moderating temperatures in late August enhanced the development of the soybean crop, although more moisture is needed for full yield potential. Much-needed rainfall arrived too late in most areas, but contacts in Illinois report that the corn crop matured rapidly from the dry conditions of early August. Overall, crops appear to be generally in good-to-excellent condition across much of the District, although pasture conditions are generally in worse shape.

According to initial USDA estimates, corn and soybean yields are expected to decline slightly in the northern parts of the District while increasing in the southern parts of the District, which are rebounding from last year's drought. Tennessee farmers expect near record-high yields for corn, and Mississippi farmers expect the same for both corn and rice. In addition, Mississippi farmers expect this fall's cotton crop to be the second-largest ever, with District production increasing by about 30 percent. Recent persistent wet weather, however, could affect yields for rice and cotton in Mississippi.

NINTH DISTRICT--MINNEAPOLIS

Overall economic activity in the Ninth District is about even with the levels last reported. Manufacturing and commercial real estate are down slightly. Tourism and agriculture are mixed. Mining and energy are about even, while residential construction and consumer spending are up slightly. Labor markets have loosened because of slow job growth and additional layoff announcements. Overall wage and price increases are moderate, with the exception of reports of energy surcharges and higher health insurance costs, and decreases in consulting fees.

Construction and Real Estate

Construction activity in the district is down slightly from a year ago. Construction contracts awarded in Minnesota and the Dakotas decreased 4 percent for the three-month period ending in July compared with the same period last year. A commercial real estate firm reported a significant increase in office and industrial sublease space in Minneapolis-St. Paul during the first half of 2001 compared with a year earlier, and expects slow office space absorption during the second half of 2001. A representative of another Minneapolis area commercial real estate firm noted slow rental activity for June and July, but an increase in activity during August.

District homebuilding is picking up and sales are strong. Authorized housing units increased 15 percent in the district for the three-month period ending in July compared with a year earlier, boosted by a 27 percent gain in authorizations for multi-unit dwellings. Sales of both existing and new homes could set a record this year in Rochester, Minn., according to a local economic development report. The number of home sales in Minneapolis-St. Paul increased 15 percent in July compared with a year ago.

Consumer Spending and Tourism

Overall district retail sales were up slightly compared with a year ago. Consumer sales were boosted in Minnesota as 2.4 million state sales tax rebates were mailed to residents in August at an average of \$330 per check. A major Minneapolis-based department store noted that overall same-store sales in August were up 2.4 percent compared with a year earlier. Managers at a mall in Montana and a mall in North Dakota noted strong back-to-school sales. In contrast, another North Dakota mall manager commented that recent sales were down 2 to 3 percent compared with last year. Recent auto sales are generally steady compared with last year in South Dakota, according to a representative of an auto dealer association.

Overall tourism activity is mixed. Motel and campground occupancies were down about 3 percent in July compared with a year ago in South Dakota. Montana tourism is steady compared with a year ago, although visits are down at Glacier and Yellowstone National Parks. According to a recent survey of resorts, hotels and other tourism businesses in Minnesota, summer occupancy rates were generally lower than a year earlier in Minneapolis-St. Paul and the southern part of the state, but were higher than a year earlier in the northern part. A bank director reported strong tourism activity in North Dakota.

Manufacturing

Overall manufacturing activity is slightly down. An August survey of purchasing managers by Creighton University indicated stable manufacturing activity in South Dakota and decreases in Minnesota and North Dakota. As evidence, a beverage-dispensing equipment manufacturer announced it would shut a Minnesota factory next year. Four circuit board manufacturing plants will be closed in Minnesota. A construction equipment producer temporarily shut down two facilities in North Dakota. However, preliminary results of a survey of manufacturers by state agencies in Minnesota, Montana and South Dakota reveal that a third of manufacturers surveyed expect increased orders in the second half of 2001 over the first half of the year, while about a quarter of respondents expect lower orders. A Minnesota machine tool manufacturer reported strong sales in August. A Montana packaging producer is expanding production and a South Dakota label producer is expanding capacity. An Upper Peninsula pet supplies manufacturer reports strong demand for its products.

Mining and Energy

Activity in the energy and mining sectors has leveled. District oil and natural gas exploration levels remain about the same as last quarter. Meanwhile, most iron ore mines are back at full production after reduced production earlier this summer, although a mine in the Upper Peninsula was temporarily shut down due to a fire. A Montana copper mine and an aluminum smelter are still closed. However, a Montana platinum/palladium mine remains at full production.

Agriculture

Agricultural conditions are mixed across the district, according to the Ninth District's third quarter (preliminary August 2001) survey of agricultural credit conditions. Strong forward contract prices for calves bode well for the South Dakota economy, said one ag lender. South Dakota lenders expect farm income to improve as 77 percent of lenders reported average to above average income levels compared with only 48 percent last quarter. "Milk

income is strong, which is completely opposite of a year ago. This has led to more rapid repayment of loans and less operating money borrowed," reported a Wisconsin lender.

Meanwhile, Montana and Minnesota bankers are concerned about the effect of adverse weather conditions on producer financial health. Over two-thirds of Montana survey respondents reported that their agricultural customers had below normal farm income over the past three months compared with a third of lenders in last quarter's survey. Minnesota bankers report that 35 percent of farm customers are at their debt limit compared with 28 percent last quarter.

Employment, Wages and Prices

Some reports of lay-offs were reported as labor markets continue to show signs of easing. For example, a computer component manufacturer announced plans to lay off 500 workers at plants in Minnesota, South Dakota and Wisconsin. Another computer-related firm plans to close a South Dakota call center with 350 employees.

District employment grew only 0.6 percent for the three-month period ending in July compared with a year earlier, the slowest rate since 1991. The number of initial claims for unemployment insurance benefits filed in Minnesota during July was 70 percent higher than a year earlier. Due to easing in labor markets, several restaurant managers noted an increase in the quantity and quality of applications. In contrast, 9 percent of South Dakota's registered nurse positions are vacant.

Increases in wages and salaries are modest. District manufacturing wages increased 2.9 percent for the three-month period ending in July compared with a year ago. Only 24 percent of respondents to an informal survey of companies in Minnesota, Wisconsin and the Dakotas reported higher wages during July compared with 58 percent a year ago. However, wages offered to newly hired workers placed through South Dakota career centers increased 6.9 percent during the fiscal year ending June 30, 2001, compared with the previous year.

Overall price increases remain modest, with increases noted in energy surcharges and insurance rates and decreases noted in consulting services. According to the informal survey of companies in Minnesota, Wisconsin and the Dakotas, only 38 percent of respondents reported higher input prices in July, down from 55 percent a year ago. Some hotels in the district have recently added \$2 to \$4 surcharges per night due to higher energy costs. Health insurance rates for employees of a Minnesota county are 13 percent higher than last year. In contrast, fees for some business consulting services have recently dropped as much as 30 percent in Minneapolis-St. Paul.

TENTH DISTRICT - KANSAS CITY

Overview. The Tenth District economy showed fewer signs of slowing in August than earlier in the summer. Retail sales were flat, the slump in manufacturing appeared to lessen, and residential construction activity edged up. Moreover, energy activity remained strong. An exception to the firming trend was commercial real estate, which deteriorated further. In the farm economy, corn and soybean crops were in good condition in some parts of the district but were hurt by dry weather in other areas. District labor markets were about the same as in the previous survey but less tight than earlier in the year, with most types of workers relatively easy to find. Wage pressures remained generally subdued. Retail prices were stable, but price pressures for manufactured goods increased somewhat.

Retail Sales. Retail sales throughout most of the district were unchanged from July to August and were similar to year-ago levels. Energy-producing areas of the region were an exception, experiencing very strong retail activity. Sales of back-to-school items, including clothing, were about the same as a year ago. Several contacts reported that sales of business attire remained particularly weak. Retailers generally reported a reduction in inventories in August. Looking forward, many managers were nervous about future sales, and several reported efforts to continue trimming inventories. Motor vehicle sales in August were mixed compared with July, but generally weak compared with a year ago. Sales of SUVs and select sports car models were stronger than sales of other vehicles.

Manufacturing. The slump in district manufacturing showed signs of lessening in August, as fewer firms reported year-over-year decreases in production. However, most indicators of factory activity remained weak, and layoffs among high-tech manufacturers continued. In addition, capital expenditures fell further below year-ago levels, suggesting that manufacturers were still taking a wait-and-see attitude toward expansion. Inventories of both raw materials and finished products continued

to decline, and most managers expect to trim inventories further in coming months.

Real Estate and Construction. Residential construction activity rebounded somewhat in August, but commercial real estate conditions deteriorated further. Housing starts were up slightly from July in most areas and higher than a year ago throughout the district. The only weakness reported by builders was in the market for luxury homes, where demand has fallen sharply. Builders expect the slightly stronger activity to continue through the fall in most areas. However, rising lot prices are expected to restrain future demand in some cities. Home sales remained solid in much of the district but continued to slow in the markets most affected by the high-tech slump. Mortgage demand expanded in August, and lenders generally expect demand to remain strong in coming months. Commercial construction activity declined slightly from July and was considerably below year-ago levels in most parts of the district. Absorption rates for office space eased further, and vacancy rates continued to rise. The majority of respondents now see evidence of excess supply in their markets, particularly for office space.

Banking. Bankers report that loans and deposits both increased slightly since the last survey, leaving loan-deposit ratios little changed. Demand edged up for commercial and industrial loans and home equity loans and increased moderately for home mortgages. Demand for other major loan categories remained unchanged. On the deposit side, all categories except large CDs increased. All respondent banks reduced their prime lending rates since the last survey, and a substantial number also decreased their consumer lending rates. Most respondents do not expect to adjust these lending rates further in the near term. About half the banks tightened their lending standards, citing such concerns as the slowdown in the overall economy and excess supply in some segments of the real estate market.

Energy. Energy activity in the district remained strong in August despite lower natural gas prices. The region's count of active oil and gas drilling rigs eased somewhat, but only after reaching a

14-year high in July. One district firm reported plans to increase its rig fleet by nearly a third over the next year. However, drilling activity in the district continues to be constrained by a shortage of rig workers.

Agriculture. The condition of the district's corn and soybean crops is mixed. Above average yields are expected in the northern part of the district, but crops in other areas have been hurt by dry weather. Timely rains are needed to improve planting conditions for the winter wheat crop. The dry weather has also hurt district pasture conditions, limiting forage supplies and discouraging district ranchers from expanding their cattle herds. Ranchers continue to post solid profits due to high feeder cattle prices. However, the high cost of feeder cattle and lower finished cattle prices have trimmed feedlot profits. District bankers indicate that small business activity in rural areas has slowed from a year ago.

Wages and Prices. District labor market conditions were about the same as in the previous survey, with most types of workers easier to find than earlier in the year. However, worker shortages continued for nurses, oil and gas field workers, and most construction trades. Some factories in rural areas were also having difficulties attracting laborers. Wage pressures remained generally subdued. Retail prices were flat for most items and are expected to remain unchanged through the fall. Price pressures for finished factory goods increased somewhat in August, as more plants passed cost increases through to customers. Most manufacturing material prices remained moderately above year-ago levels. Plant managers generally expect a flattening of material prices in coming months. Some builders reported increases in lumber and wallboard costs. However, these increases are expected to be temporary.

ELEVENTH DISTRICT—DALLAS

Eleventh District economic activity continued to weaken in August and early September. Manufacturing, construction and real estate activity continued to decline. Demand remained slow for most business services, and contacts in the financial services industry reported a gradual softening of conditions. The energy industry also slipped a little. Retail sales were slightly improved, but still weak. The agricultural industry has been hammered by another hot, dry summer.

Prices and Labor Markets. There were more reports of price decreases than price increases. Most manufacturers said selling prices were unchanged or lower, and some expect softening demand to push prices down further in coming weeks. Many manufacturers reported that inventories have fallen to acceptable levels, except for some construction-related products and telecommunications where inventories are high. Telecom firms say older inventory is becoming obsolete as new products and technologies become available. Telecommunications firms say input costs are falling but not as fast as selling prices. Most service contacts reported little change in fees. Airlines say fares are lower. Retailers said selling prices were unchanged or down, and one noted that customers are tending to purchase the item with the fewest features and the lowest price. Several industries noted that the fall in natural gas prices has been beneficial, and energy surcharges for natural gas have been eliminated or reduced.

Cool weather, weak industrial demand and rising inventories pushed the spot price of natural gas down from \$3 per thousand cubic feet in late July to \$2.30 just before Labor Day, the lowest price for natural gas since December 1999. Downward pressure is expected to continue until the first cold weather hits the Northeast, perhaps in two months. Crude oil prices held between \$26 and \$28 per barrel despite the slowest growth in global demand since the 1997-98 Asian financial crisis. Supporting crude prices was OPEC's announcement that it would remove one million barrels per day of production from the market beginning September 1. Gasoline prices have increased since the last Beige Book because of a series of delivery problems in the refinery system. U.S. demand for gasoline has been surprisingly strong in August, reaching nearly 10 million barrels per day, the strongest demand in 22 years.

Labor markets continued to loosen, and layoffs are still reported. As a result, many firms say hiring is less difficult and the quality of the workers has improved. Turnover has also decreased, which is improving productivity according to one contact, because workers have more experience. Another contact remarked that people are "holding on for dear life" to their current jobs. While only a few industries reported wage pressures, several expressed serious concern about rising health care costs.

Manufacturing. Manufacturing activity continued to decline. Some high-tech firms reported a slight improvement, but demand for construction-related materials and oil field equipment have begun to soften, and the outlook for these producers worsened.

Cement producers reported slowing demand over the past six weeks, with particular weakness in Austin. Brick shipments remain at high levels but bookings for new jobs are down, and backlogs are shrinking. Glass producers reported softening demand for construction but a pickup in sales to the auto

industry. Sales of metals—both primary and fabricated—has slowed, and contacts reported a drop off in new orders to supply all types of industries, including parts used by the energy industry. Lumber sales continued to decline, and contacts say their customers are becoming quite apprehensive about the future. One contact closed a plant and is having difficulty selling off the inventory. The paper industry continues to report slow sales, with shipments and orders below last year's levels. Producers are running their plants as much as 15 percent below capacity. Demand for food products was mostly unchanged, and apparel producers said that sales were below the levels of a year ago.

The high-tech industry is mixed with some contacts saying they are gaining confidence that the bottom has been reached. These contacts report that demand has flattened in the past three to four weeks, and inventory levels are very lean. Respondents do not expect any significant uptick in demand until at least the first quarter of 2002. On the more negative side, personal computer manufacturers report that sales and prices continue to fall. Telecommunications contacts reported that demand for networking equipment and services has not improved and may have slipped further. Revenues in the telecom industry are well below previous years, according to contacts, who say capital spending has dried up.

The combination of supply disruptions and strong demand has improved refinery margins, but only to moderate levels. The decline in the price of natural gas has helped the competitive position of U.S. chemical producers relative to the rest of the world, particularly as the price of oil has remained well over \$20 per barrel. However, weak domestic and foreign demand for chemicals, plus new capacity that has come on line around the world has kept chemical prices very weak. The contract price for ethylene suffered the biggest decline ever (two and a half cents) in July, as producers were unable to maintain improved margins as the price of gas fell. Further downstream, the price of plastics, such as polyethylene and PVC fell along with the price of ethylene. Profits along the entire supply chain remain stable, but at very low levels.

Services. Demand continued to be slow for most business services, but there have been signs of improvement. Temporary firms say that activity is slow but has not worsened since the last Beige Book. Legal contacts also reported little change in overall levels, which are slightly lower than a few months ago. However, slower transactional work has been replaced by a pick up in bankruptcies. Demand for transportation services remains soft. Airlines continued to report a sharp slowdown in business travel. Trucking firms reported somewhat slower demand, partially because of fewer high-tech shipments. Railroads say activity remains slow but has moderately improved since the last Beige Book. Shipments of energy-related commodities, such as coal, have been especially strong. Shipments of international containers are up, while domestic intermodal shipments are down.

Retail Sales. Retail sales were slightly improved, although still weak, according to contacts who say their profits were down. Discount stores reported better sales results than other retailers, and one contact concluded that customers are gravitating toward value. Sales along the Texas-Mexico border were strong, but sales in Austin and the Dallas/Fort Worth area were poor. Auto sales were "good" but lower than a year ago. Auto inventories are slightly above desired levels, keeping pressure on selling prices.

Retail sales in Houston remained strong, with particularly strong auto sales, which contacts attribute in part to replacing damage caused by Tropical Storm Allison.

Financial Services. Respondents continued to report a gradual softening of conditions. Deposit growth has slowed as interest rates have fallen. Loan demand is continuing its slowing trend, except in the Houston area where loan demand remains strong. Contacts say that weakening demand is driving down margins. Most contacts expect the economic slowdown to impact their business throughout the remainder of this year and do not see real recovery until the second half of next year.

Construction and Real Estate. Overall construction and real estate activity continued to deteriorate. Real estate markets are particularly weak in Austin. Commercial markets are overbuilt in Dallas and Austin—the district’s high-tech areas—where weak demand and a lot of sublease space are putting downward pressure on rents. However, a few contacts report that sublease space is being announced at a considerably slower pace over the past six weeks.

High-end residential housing markets remain weak, with the market above \$250,000 still considered overbuilt. Home sales in the lower price points remained strong, but contacts say sales are taking longer and the cancellation rate has increased. Builders say they have lowered prices to retain sales volumes, reducing their margins. Some contacts report fewer corporate relocations to the area compared to past years. Multi-family activity is “amazingly strong” in Houston and stable in Dallas. Houston office and residential markets are still very strong.

Energy. The domestic rig count declined slightly from 1275 in late June and July to about 1250 working rigs. Most of the decline came out of gas-directed drilling, and probably half of that from reduced offshore activity in the Gulf of Mexico. The result has been reduced rates for these rigs. The rig utilization rate for oil-directed North Sea rigs has risen to 100 percent, however. Oil services and supply boats report that there has not been enough of a decline to adversely affect the demand or pricing for their services.

Agriculture. Hot, dry weather has battered crops and livestock. Recent rains, while beneficial in some areas, were mostly too little and too late to help many of the failing crops. Texas cotton producers have abandoned nearly 2 million of the 6.2 million acres planted. This is the fourth year out of the last six years that drought has cut the Texas crop. Rains helped pastures and ranges and replenished stock ponds in many areas. However, some areas received very little or no rain and remain dry. Supplemental feeding of livestock continued in many areas.

TWELFTH DISTRICT – SAN FRANCISCO

Summary

Reports from Twelfth District contacts indicated additional slowing in economic growth during the survey period of August and early September, with limited upward pressure on wages and prices. Wholesale energy prices have fallen, but retail electricity rates remained high. Consumer spending softened a bit in most areas. Continued weak demand was reported by manufacturing contacts, although previously high inventories have been worked down in some sectors, and contacts reported that orders for high-tech equipment may be improving a bit. Due to uncertainty about future sales, however, manufacturers and other businesses generally focused on maintenance of existing productive capacity, rather than expanding capacity. In real estate markets, demand for commercial and industrial space remained weak, while demand for residential property was solid in most areas. District agricultural output was high and prices low. Lending activity by financial institutions slowed in some areas, as borrowers reduced their demand for credit and banks tightened lending standards on business loans.

Wages and Prices

Reports indicated small wage increases in general and little or no upward pressure on the prices of final goods and services. Wholesale prices for natural gas and electric power have fallen substantially since earlier this year, easing margin pressures for energy distributors and reducing operating costs for businesses that purchase wholesale electricity. Although capacity constraints for electrical generation and transmission are still evident, increased generation capacity in California and other areas has combined with lower natural gas prices and lower usage to reduce wholesale electricity prices; retail prices, however, are above last year's levels. In regard to consumer goods, respondents noted extensive discounting and clearance sales for

small and large items, and prices for retail goods and services reportedly were flat to down overall. Wage pressures were moderate, with observed increases in a variety of sectors ranging from 2 percent to 4 percent on an annual basis. One respondent in the Pacific Northwest noted significant easing in previously tight labor markets, with far more job applications received for existing openings than in the past.

Retail Trade and Services

Demand for retail merchandise was flat to down during the survey period. Sales in most areas reportedly declined for durable and nondurable products alike, with contacts specifically mentioning reduced sales of automobiles, home appliances, home computer products, and apparel. The only exceptions to reports of weak retail sales were indications of continued spending growth in parts of Southern California and in Hawaii, and continued strong sales of pharmaceuticals in most areas. Several respondents attributed sluggish spending to consumer caution induced by uncertainty about future economic prospects.

Reports regarding demand for consumer and business services were somewhat downbeat. Employees at law firms in the Pacific Northwest faced ongoing layoffs, especially by firms that focus on corporate finance, and activity in the restaurant trade slowed in California. However, respondents from Hawaii noted that hotel receipts and other tourist-related commerce held steady or picked up somewhat.

Manufacturing

Demand was weak and production activity was sluggish in all areas of manufacturing. Sales remained depressed for most durable manufactured products, such as industrial equipment and forest products, and orders for commercial aircraft reportedly were “weak and may get worse.” According to several contacts, sales of high-tech equipment were slow but may have

bottomed out, as orders for personal computer and communications products improved a bit during the survey period. Contacts in high-tech manufacturing and other sectors reported that inventories have been reduced, with one respondent pointing out that the inventory buildup in manufacturing was addressed “more rapidly and efficiently than in past economic slowdowns.” However, inventories of high-tech products reportedly remained high during the survey period, and further improvement in high-tech and industrial equipment sales will be hindered by business caution regarding new investment. Respondents from all sectors noted that businesses generally are focusing on maintenance of existing productive capacity, with little or no plans to expand capacity until substantial improvement in final demand is evident. For example, capital spending outlays in the semiconductor manufacturing industry this year are expected to be nearly 30 percent below last year’s levels.

Agriculture and Resource-related Industries

Agricultural contacts reported that yields, availability, and quality were good during August and early September, but prices were low. Inventories were high for a variety of products, notably cotton, almonds, pecans, tomatoes, and dried fruits. As a result, farmers generally faced low market prices for these products. Cattle ranchers also struggled somewhat, as increased demand for beef was matched by increased supply, keeping prices low.

Real Estate and Construction

Reports indicated little change from ongoing softness in the markets for commercial, industrial, and retail space. Weakness was most evident in high-tech centers, especially in Oregon, California, and Washington. Vacancy rates on office space reportedly rose into double digits in Seattle, compared to 4 percent at this time last year.

Demand for residential property remained solid in the District, although some areas

showed signs of moderation. Reports indicated that in most areas home purchases continued at a solid pace, due in part to lower mortgage rates. In Hawaii, apartment rents increased noticeably, due to rising demand combined with limited new construction. However, contacts noted a slowdown in sales of upper-end homes in California, and in Utah homes were staying on the market longer and sellers showed increased willingness to negotiate on prices and terms.

Financial Institutions

Lending activity and credit conditions in the District were mixed. Loan demand by businesses and consumers was weaker during the survey period than earlier in the year, and loan activity was further reduced by banks' imposition of tighter credit standards for business loans. However, a respondent in Southern California noted that loan demand remained "healthy" there, and mortgage loan activity was strong in most areas as households took advantage of low mortgage interest rates.