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Summary of Commentary on _____

Current Economic Conditions

By Federal Reserve District

January 2009

SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICTS

JANUARY 2009

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Summary*

Overall economic activity continued to weaken across almost all of the Federal Reserve Districts since the previous reporting period. Most Districts noted reduced or low activity across a wide range of industries, although a few Districts noted some exceptions in some sectors.

District reports indicate that retail sales were generally weak, particularly during the holiday season. A majority of Districts noted deep discounting during the holiday sales season. Vehicle sales were also weak or down overall in the Districts reporting on them. Manufacturing activity decreased in most Districts. Declines were noted in a wide range of manufacturing industries, with a few exceptions. Services sector activity generally declined across the Districts, with exceptions in some sectors of the Boston, Richmond, and Chicago Districts. Additionally, several Districts noted weaker conditions in transportation services and slow or decreased demand in tourism activity. Conditions in residential real estate markets continued to worsen in most Districts. Reduced home sales, lower prices, or decreases in construction activity were noted in many Districts. Commercial real estate markets deteriorated in most Districts, with weakening construction noted in several Districts. Overall lending activity declined in several Districts, with tight or tightening lending conditions reported in most Districts. Credit quality remained a concern in several Districts. Agricultural conditions were mixed in response to varying weather conditions across the Districts. Mining and energy production activity generally declined since the previous report.

Most Districts reported a general weakening of labor market conditions. Lower energy prices were noted in many of the Districts, and, except for the Richmond District, which mentioned higher prices for raw materials, most reporting Districts noted declining input prices. Wage pressures remained largely contained, and some Districts reported pay freezes or reductions in compensation.

* Prepared at the Federal Reserve Bank of St. Louis and based on information collected on or before January 5, 2009. This document summarizes comments received from business and other contacts outside the Federal Reserve System and is not a commentary on the views of Federal Reserve officials.

Consumer Spending

Reports of retail sales during the holiday season were generally negative in most Districts. Retail sales during the holiday season were weak or mostly down in the Boston, New York, Philadelphia, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco Districts. However, some contacts in the Boston and New York Districts noted that sales picked up after the holidays. Retail sales in the Cleveland District were flat to down in November (on a month-over-month basis). Most retailers in the Richmond District had disappointing sales during the holiday season. Discount stores fared relatively better in the Philadelphia, Cleveland, Atlanta, Chicago, and San Francisco Districts, although discount stores in the Dallas District reported weak holiday sales. Deep discounting during the holiday season was reported in the New York, Philadelphia, Atlanta, Chicago, Minneapolis, Kansas City, Dallas, and San Francisco Districts. Several Districts reported that luxury and big-ticket items (e.g., jewelry, appliances, and electronics) were weak sellers. Richmond reported that sales of gift cards were weaker than the previous year. In the New York District, cold-weather apparel was a relatively strong seller. Many retailers in the Philadelphia, Atlanta, Kansas City, and Dallas Districts expected continued weakness or sluggish sales. However, expectations were mixed in the Cleveland District, and retailers in the Boston District were watchful.

Each of the ten Districts that reported on vehicle sales indicated that sales during the season were weak or down overall (Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco). Sales of domestic brands were especially weak in the Richmond and Dallas Districts. Chicago reported increased demand for light trucks and San Francisco reported a slight increase in sales of larger used vehicles. Both of these changes were reported to be in response to falling gas prices. In addition, Dallas reported an increase in sales of used vehicles. Several Districts reported a negative outlook among car dealers.

Manufacturing and Other Business Activity

Manufacturing activity continued to fall in most Districts since the previous report, with declines reported across a wide range of industries. Cleveland noted a slump in steel shipping and Chicago noted

that domestic steel production slowed. Dallas and Philadelphia indicated that industries related to construction experienced large drops in orders, and Richmond noted that import activity for construction and household products remains notably low. San Francisco reported that activity for producers of wood products remains depressed. Kansas City, St. Louis, Cleveland, and Dallas noted decreases in auto and auto-related manufacturing activity. Cleveland, Dallas, and San Francisco reported that capacity utilization was below normal levels or declined. Boston, Philadelphia, Cleveland, Minneapolis, Chicago, and Kansas City mentioned reductions in capital spending or plans to reduce capital spending in 2009. In contrast, firms in defense and medical-device production in the Minneapolis District reported increased activity, and San Francisco noted that aerospace manufacturing continued at a high level. Food manufacturing and processing remained active in the Philadelphia and Dallas Districts and solid in the San Francisco District.

Activity in the services sector declined throughout most Districts. Cleveland, Richmond, Atlanta, St. Louis, Kansas City, and Dallas reported slowed or declining activity for transportation services, often related to the shipping of construction and manufactured goods. San Francisco, St. Louis, New York, Chicago, Kansas City, and Minneapolis reported declines in travel or tourism-related services. Richmond and Atlanta noted that tourism activity was mixed, and Boston indicated that a majority of consulting and advertising firms reported stable to strong demand. Service activity at auto dealers continued to be robust in the Chicago District, and it increased in the Dallas District.

Real Estate and Construction

Residential real estate activity continued to weaken in nearly all Districts. Boston, Philadelphia, Cleveland, Richmond, Atlanta, St. Louis, Kansas City, and Dallas reported that home sales were weak or had declined. San Francisco reported that despite some pickup in recent months, home sales continued to be quite slow in most parts of the District. In the New York District, the market for new homes continued to weaken in New Jersey, and the higher-priced housing markets nearest to New York City were characterized as especially weak. While the Minneapolis District reported that late December saw an uptick in residential sale activity in the Minneapolis-St. Paul area, it was reportedly driven by foreclosures

and short sales. Increased home sale cancellations were common in a few Districts. Contacts in the Dallas District reported that home sale cancellations remained prevalent, in some cases outpacing sales. Elevated cancellation rates and weak showroom traffic in the Chicago District led developers to remain cautious about expanding inventory levels, and some building contractors in the Cleveland District reported increased inventories because of take-backs from home sales that fell through. Boston, Philadelphia, Atlanta, Kansas City, and San Francisco reported that home prices continued to soften or fall. Median selling prices declined in and around New York City and were reported to have edged down in the Dallas District. Richmond, however, reported that home prices remained steady.

Reporting Districts generally saw a decrease in homebuilding. Atlanta reported that homebuilders continued to pull back on home construction. The Philadelphia and Chicago Districts noted that residential building continued its decline. Residential construction was down in the St. Louis District, remained weak in Cleveland, and was quiet in Minneapolis.

Commercial real estate markets deteriorated in most Districts. Contacts in the Boston District described the commercial real estate market as grim and depressing, and market conditions continued to deteriorate in Richmond. In the Minneapolis District, a contact noted that the market remained in a downturn that has now lasted more than a year. Commercial real estate transactions in the Dallas District have reportedly ground to a halt. Leasing activity was minimal in the Boston District, continued to fall in the Philadelphia District, and was assessed as ranging from slowing to frozen in the Richmond District. Contacts in the Chicago District reported increases in sublease space. Office and industrial leasing is expected to remain steady through the first half of 2009 in the St. Louis District, but San Francisco reported that conditions in their commercial office market remained exceptionally weak. The New York District reported that Manhattan's office vacancy rate climbed to its highest level in two years. Contacts in the Chicago District noted elevated vacancy rates, and contacts in the Kansas City District expected higher vacancy rates going forward. Contacts in the Atlanta District also anticipate that more commercial space will become available.

Reports about commercial construction activity also were downbeat. In the Philadelphia District, commercial construction activity continued to fall. Cleveland reported that construction backlogs have declined for some contractors. Commercial contractors in the Atlanta and Chicago Districts reported declines in building activity and noted that more projects were cancelled or postponed. In St. Louis, contacts in commercial and industrial construction predicted a challenging environment in early 2009. San Francisco reported that commercial construction activity was very limited. Construction-related manufacturing contacts in the Dallas District reported that demand from commercial construction is shrinking rapidly.

Banking and Finance

Most Districts that reported on lending activity indicated that it continued to decline or remained weak, and many Districts reported that credit conditions remained tight or tightened further. Overall lending activity was reported to have slowed or declined in New York, St. Louis, Kansas City, and Dallas; it remained soft or weak in the Chicago and San Francisco Districts. Philadelphia reported a slow rise in outstanding loan volume with gains in real estate loans and consumer credit, but no business-loan growth. Demand for commercial loans was stable to decreasing in the Cleveland and Richmond Districts. Kansas City reported that demand fell for commercial and industrial loans, while San Francisco indicated that commercial and industrial loan volumes were at very low levels. In contrast, St. Louis reported a slight increase in commercial and industrial loans. New York, Cleveland, Richmond, Chicago, Kansas City, and San Francisco noted an increase in residential mortgage refinancing activity. Demand for consumer loans declined in the Cleveland, Kansas City, and Dallas Districts. St. Louis reported an increase in loans to individuals.

Regarding credit conditions, Boston reported that credit availability continues to be a major barrier to commercial real estate activity, and San Francisco noted that the availability of credit remains quite constrained. The New York and Atlanta Districts indicated a general tightening of credit standards, while Kansas City noted tighter standards for commercial real estate and commercial and industrial loans. Credit standards were described as unchanged to tightening further by Cleveland and Richmond, while

Dallas noted that depository institutions maintained tight credit standards. Chicago reported that credit conditions remained tight. Credit quality declined or remained a concern in the New York, Philadelphia, Cleveland, Chicago, Kansas City, Dallas, and San Francisco Districts. Default rates on commercial loans are expected to rise in the Boston District. Richmond indicated mixed reports on credit quality.

Agriculture

Weather conditions since the previous report had mixed effects on agricultural activity. Recent rain eased drought conditions in most of the Atlanta District, while parts of the Dallas District were still severely dry. Weather conditions allowed for fieldwork in the Atlanta and Minneapolis Districts but delayed fieldwork in the Richmond and Chicago Districts. The winter wheat crop in the Kansas City District was in good condition, while winter wheat development in the Richmond District was hindered by cooler temperatures and rain in recent weeks. The livestock sector in the Kansas City District and the poultry sector in the Atlanta District reported slowed activity, while production of red meat and some types of poultry decreased in the St. Louis District. The Atlanta, Kansas City, Dallas, and San Francisco Districts reported that farm input costs (e.g., fuel and fertilizer) have moderated or declined recently. Dallas reported that commodity prices have dropped, but Chicago and Kansas City reported that corn and soybean prices have rebounded slightly.

Natural Resource Industries

Activity in the energy sector declined in several Districts since the previous report, with a number of Districts linking the decrease to lower energy prices. In the Atlanta and Minneapolis Districts, oil and gas exploration declined. Kansas City reported a dramatic slowing in energy activity, and Dallas reported a decrease in drilling activity and a decline in the number of active oil rigs since the previous survey. In contrast, energy production did not change in the Cleveland District, and coal production in the St. Louis District was higher in December 2008 than in December 2007. Looking ahead, contacts in the Cleveland and Kansas City Districts expect drilling activity to decline for the first few months of 2009. Regarding capital spending, contacts in the Atlanta District indicate that oil and gas exploration firms re-evaluated expansion plans in response to lower oil prices and difficulty obtaining credit. Energy producers in the

Kansas City District are cutting capital budgets, but producers in the Cleveland District expect little change to their capital spending in early 2009. Finally, iron ore production in the Minneapolis District decreased since the previous report.

Labor Markets

Most Districts reported a general weakening of labor market conditions. Most Districts reported that layoffs continued, and Boston, Cleveland, Richmond, Atlanta, and Dallas noted hiring freezes for select firms. Atlanta, Chicago, and Dallas reported reduced hours to control costs. Job losses in the manufacturing sector were reported by contacts in the Cleveland, Richmond, Chicago, St. Louis, Minneapolis, Kansas City, and Dallas Districts. Dallas noted that layoffs were becoming widespread in the energy industry, and New York noted that a substantial number of job reductions in the financial sector have yet to show up in payroll statistics. Richmond reported weaker demand for temporary workers. In contrast, contacts in Chicago indicated that demand for skilled workers remained strong. Richmond noted that demand was strongest for workers providing professional and support services, workers with high-level technical skills, and workers proficient in computer software. Chicago noted employment growth in the education, government, and healthcare fields. St. Louis also noted job growth in some small business support services firms. Cleveland reported continued hiring in defense-related and healthcare industries.

Prices

Consumers saw sizable holiday price cuts in retail stores in a majority of the Districts. Retail contacts in the New York, Philadelphia, Atlanta, Chicago, Minneapolis, Kansas City, Dallas, and San Francisco Districts reported heavy holiday discounting. Retailers and restaurant contacts in the Kansas City District lowered prices and anticipated further declines in the months ahead. Lower energy prices were noted throughout many of the Districts. Most contacts in the Atlanta District reported reduced input price pressures, and about half of the contacts in manufacturing and related services in the Boston District reported falling input prices. Boston reported large price decreases for energy, oil-based materials, paper, and cotton in particular. In the Kansas City District, raw materials prices fell sharply, and manufacturers

in general reported a corresponding decline in finished product prices. Manufacturers in the Philadelphia District also reported decreases in commodity prices and some reported a reduction in the prices of their own products as well. Contacts in the Cleveland District observed that the downward trend in raw materials prices has started to level off and that pricing of manufactured products remained relatively stable. On the other hand, the Richmond District noted that raw materials prices rose at a slightly quicker pace since last reported. Contacts in the San Francisco District reported that they expect upward price pressures to remain very limited during early 2009.

Wages

Wage pressures remained largely contained in most Districts. The Cleveland, Chicago, Dallas, and San Francisco Districts reported little to no wage pressures. Richmond noted that wage gains in the retail sector held up, but average wage increases slowed for service firms. Wage increases were modest in the Minneapolis District, and wage pressures diminished in the Kansas City District. A few Districts experienced slowing wage gains in sectors that had previously seen rapid wage advances, notably the energy sector in the Cleveland District and the technology sector in the San Francisco District. According to reports from the New York District, year-end bonuses at financial firms are seen falling 20 to 30 percent from a year ago at some of the smaller firms but more substantially at the larger establishments. The Boston, Chicago, and San Francisco Districts also noted that some contacts are enacting or considering pay freezes or reductions in compensation.

FIRST DISTRICT – BOSTON

Business activity in the First District continued to slow at the end of 2008. Retailers report sluggish holiday sales, and manufacturers cite smaller increases or actual declines in revenues or orders in the fourth quarter compared with a year earlier. Selected business services firms are somewhat more upbeat, with demand in the fourth quarter stable versus year-ago levels. Residential and commercial real estate markets remain very weak. Respondents expect more of the same or further softening, at least through the first quarter. Many contacts point to declining costs as a silver lining.

Retail

Contacted First District retailers report weak sales for the holiday months of November and December, but several contacts note that sales were not as soft as expected. On average, same-store sales are flat to down by single-digit percentages among contacted retailers. However, a few respondents indicate that sales picked up either just before Christmas or after New Year's Day, and continue to be stronger than anticipated.

Retailers continue to manage inventory levels tightly and are cutting 2009 capital spending plans. Respondents have invoked hiring freezes and some are considering reducing headcount in the near future. One contact notes that lack of consumer credit has negatively affected sales.

Overall, First District retailers are watchful in their outlook as they expect consumers to “hunker down” over the next few months.

Manufacturing and Related Services

Almost all manufacturing and related services contacts headquartered in the First District say that the pace of business slowed in fourth quarter 2008 compared to trends earlier in the year. Makers of products purchased by consumers, retailers, and restaurants generally characterize business as “sluggish” or “slow.” Some of these firms are experiencing double-digit decreases in revenues or orders from year-earlier levels. Capital goods producers report that most of their business customers are spending cautiously as a result of economic uncertainties. Some specifically mention that they did not experience the usual year-end surge in equipment sales reflecting customers' rush to use current-year budgets or preparations for the coming year.

About one-half of the respondents indicate that falling input costs had a beneficial impact on margins in the fourth quarter. They cite large price decreases for energy, oil-based materials, paper, and cotton in particular. The remaining respondents mostly report that input prices have been stable. Roughly half of the contacted manufacturers and related services providers raised selling prices by single-digit rates in late 2008 or expect to do so in early 2009, while the remaining firms report no changes or are rethinking planned increases. A few respondents say they have experienced or expect to experience downward price pressures as a result of the weakening economy.

Most contacted firms anticipate cutting employment and capital spending in 2009. Those reporting on intended pay increases for 2009 say they will be below those in recent years. Companies

typically are planning raises that are 0.5 percentage point to 1.5 percentage points lower than in 2008, but some are enacting partial or across-the-board pay freezes.

All responding manufacturers and related services providers express some degree of caution or concern about their sales throughout 2009. Contacts with a strong competitive position or selling to slow-moving market segments are relatively optimistic and expect little or no revenue growth. Others are very concerned as they “manage one day at a time” or foresee potentially large drop-offs in business during the first quarter. Overall, respondents view the economic environment as highly uncertain and subject to substantial downside risks in the coming year.

Selected Business Services

The majority of consulting and advertising firms contacted in the First District enjoyed stable or strong demand in the fourth quarter and during 2008. Responding businesses—most of which are consulting firms—report over-the-year growth ranging from 2 percent to 35 percent. Demand from the healthcare sector continues to be strong and is expected to improve further in 2009. However, demand from the building and retail sectors is said to have weakened significantly.

In the fourth quarter, costs remained stable or decreased for all the firms contacted. Several firms report introducing cost-reducing strategies, and most respondents held wages and salaries stable in 2008. The majority of New England business services respondents did not increase prices in 2008 and expect to keep them stable in 2009; firms that might increase prices are confident of market acceptance. Headcounts were stable or up year-over-year among contacted firms. Respondents’ plans for 2009 range from holding employment stable to increasing headcounts 10 percent to 15 percent.

Most New England consulting firms are optimistic about the 2009 outlook. They expect to continue growing, especially after the first quarter of 2009. They suggest this positive scenario might change, however, if the economy has not started to recover by the second half of the year.

Commercial Real Estate

Conditions in the commercial real estate market deteriorated further in the month of December. Contacts describe the situation as “grim” and “depressing.” Credit availability continues to be cited as a major barrier to sales activity. One contact reports that a senior lending officer for commercial property at a large bank has been instructed to “try to prevent developers from making further draws on existing lines of credit.” In contrast, however, a regional lender based in Boston notes that, for the first time in many months, an originator of securitized commercial real estate loans financed the purchase of a small retail shopping center.

In Connecticut, leasing and sales activity for commercial real estate are virtually non-existent, according to our contact, and law firms are experiencing negative fallout due to the dearth of transactions. Hartford’s major insurance companies have begun to lay off workers; while the cuts have been measured so far, expected job losses in the coming months could have a significant impact on the region’s office vacancy rate. In Rhode Island, industrial plant closings have been observed and more are expected in the

near term; our contact reports these closings will result in vacancies that will be hard to fill. In southern Rhode Island, there is an estimated 4 to 5 years' supply of office space currently on the market; while the situation is better in downtown Providence, office vacancies are expected to climb there as well in the coming months.

In Boston, leasing activity is reportedly minimal in all sectors, and is occasioned only by necessary lease renewals or forced moves, as tenants expect rents to continue to fall. One contact reports that their retail clients are "staying alive and continuing to pay the rent," although he expects retail closings to emerge in the first quarter as firms come to terms with weak holiday sales. Sales activity is non-existent for large commercial deals (over \$50M) and slow for smaller deals. Capitalization rates (ratio of net operating income to property value) edged up again in the Boston area and contacts expect them to increase an additional 50 to 75 basis points in the coming months across all property types; rising cap rates are consistent with reports that commercial property values are down both regionally and nationally. Low transactions volume makes it difficult to track property value movements for metro areas in New England, but one contact notes that portfolios of geographically-diversified commercial real estate owned by large pension funds will be written down by 20 percent to 30 percent for the year 2008.

The outlook remains very pessimistic. Contacts do not expect recovery in commercial property markets in the course of 2009. More layoffs are expected across all sectors in the region, leading to rising vacancy rates. Default rates on commercial loans are also expected to rise, both regionally and nationally. Regarding the latter, one contact is concerned that banks and life insurance companies holding commercial real estate loans are not preparing adequately for further capital losses.

Residential Real Estate

After modest decreases and some increases in sales in New England in September and October, home sales dropped sharply year-over-year in November. In Massachusetts, Maine, and New Hampshire, November home sales dropped 22 percent or 23 percent year-over-year. Massachusetts condo sales declined 27 percent year-over-year in November. While the rest of the region saw decent sales numbers in October, Connecticut's home sales declined 17 percent compared to the year before.

Prices also continued to decline. The median home sales price in Massachusetts fell 14 percent year-over-year in November while the median condo price declined 9 percent. Median home prices dropped 17 percent in New Hampshire and 8 percent in Maine in November compared with a year earlier. In Connecticut, the median home sales price declined nearly 11 percent year-over-year in October.

Financial market stress and resulting problems in the general economy are said to be having a major impact on residential markets. One contact believes that worries about employment are discouraging potential buyers. Other respondents express concern about the efficacy of federal legislation intended to stimulate the housing market; they specifically note issues with the tax credit for new homebuyers, including consumer information gaps about the time lag between home purchase and receipt of the credit and the need to pay back the credit eventually.

SECOND DISTRICT--NEW YORK

The Second District's economy has weakened somewhat more since the last report, though some sectors appear to have stabilized to varying degrees. The labor market has shown further signs of deteriorating, particularly in New York City. Retailers generally report that holiday-season sales were somewhat lower than in 2007 and a bit weaker than anticipated; retail prices were flat to down modestly, while retail inventories were at or near desired levels. Tourism activity in New York City slowed further in November and December. Both residential and commercial real estate markets were mixed since the last report, with New York City weakening more than other areas. The financial sector has weakened further, and sizable declines in both employment and compensation are anticipated in 2009. Finally, bankers report declining loan demand across all categories, continued widespread tightening in credit standards, and higher delinquency rates—especially on loans to the household sector.

Consumer Spending

Retail sales for the holiday season are described as sluggish but not disastrous. Same-store sales are reported to have been down moderately in December, compared with a year earlier, and somewhat below plan—especially in New York City. At least some of the weakness was attributed to severe weather in the days leading up to Christmas. However, one major chain reports a noticeable pickup in sales in the final days and maintains that weather was not much of a factor. Post-holiday sales are reported to be up somewhat from a year ago and ahead of plan. In general, sales of cold-weather apparel are characterized as relatively strong, while sales of luxury items are reported to have been somewhat sluggish. Contacts report somewhat heavier discounting than during last year's holiday season, though selling prices, on average, were reportedly flat to down modestly from a year earlier. Major retail chains report that year-end inventories were at or near desired levels.

Consumer confidence was generally at or near record lows in November and December: After hitting a record low in November, Siena College's monthly survey of New York State residents showed

consumer confidence edging up in December, while the Conference Board reports that consumer confidence among residents of the Middle Atlantic states (NY, NJ Pa) dropped to its lowest level on record in December.

Tourism activity in New York City has shown further signs of weakening since the last report. Both occupancy rates and room rates at Manhattan hotels tumbled in November and remained weak in December, pushing overall revenues down nearly 20 percent from a year earlier. Broadway theaters also report further weakening in business: attendance in December was down roughly 7 percent from a year earlier, while revenues fell 2½ percent; moreover declines were increasingly steep toward the end of the month. Further declines are anticipated, as nine Broadway shows closed just this past weekend and another four plan to wind up their runs by the end of January—an unusually weak start to a new year.

Construction and Real Estate

Housing markets in the District have been mixed but generally weak since the last report. A New Jersey industry contact reports that the market for new homes continues to weaken, reflecting an ongoing overhang of inventory, but notes some leveling off in the resale market—both in terms of volume and prices. However, the more high-priced areas nearest to New York City are still characterized as especially weak. In particular, one contact specializing in the higher end of the market reports that sales activity has slowed considerably—with buyers increasingly reluctant, many sellers are taking their homes off the market. Home prices are estimated to be down roughly 20 percent from their peak levels of a couple years ago.

New York State Realtors report that home sales continued to weaken in November, falling nearly 24 percent from a year earlier and that median selling prices posted double-digit percentage declines in and around New York City but were mixed across upstate New York. There appears to have been substantial deterioration in Manhattan's housing market, based on reports from both a major appraisal firm and a large real estate brokerage. Co-op and condo sales fell roughly 9 percent from a year earlier in

the fourth quarter, led by a 25 percent drop in sales of existing apartments (re-sales). In contrast, closings of newly-constructed units surged 35 percent from a year earlier, but these largely comprised contracts negotiated in late 2007 and early 2008. Based on current contracts, overall apartment prices fell by 20 percent or more from the third to the fourth quarter and the number of transactions fell sharply. Manhattan's apartment rental market has also weakened substantially, with asking rents reported to be down across the board in November, and 2 to 6 percent lower than in June; moreover, an industry report maintains that the reported decline in asking rents likely understates the true weakness in the market, with a growing number of landlords offering concessions. The inventory of available rental units reportedly increased 17 percent between September and November, with a particularly large rise in the number of high-end listings.

Office markets in the District were mixed in the fourth quarter. Manhattan's office vacancy rate climbed to its highest level in two years, while asking rents fell 8 percent from the third quarter and were down 5 percent from a year earlier. An industry contact notes marked weakening in December, in particular. However, office markets in the outlying areas were steady: Vacancy rates in northern New Jersey, Westchester and Fairfield County (CT) were little changed at high levels, while Long Island's rate fell to a two-year low; asking rents were little changed from a year ago in all these areas. Office markets in upstate New York metro areas were steady to somewhat stronger in the fourth quarter, with vacancy rates down slightly and rents up modestly overall.

Other Business Activity

A contact monitoring the financial sector maintains that the industry is still far from hitting bottom. At the larger institutions, a substantial number of job reductions in the pipeline have yet to show up in the payroll statistics, due to ongoing severance payouts. Moreover, year-end bonuses are seen falling 20-30 percent from last year at some of the smaller, healthier firms but more substantially at the larger establishments.

More generally, labor market conditions remain very weak. Both manufacturing and non-manufacturing firms in the District report that they expect employment to decline over the course of 2009, by an average of roughly 2 percent. The overall number of layoffs is expected to be significantly greater in 2009 than in 2008, particularly among non-manufacturing firms. While fewer workers are expected to quit this year than last, somewhat more are expected to retire. Separately, a major New York City employment agency, specializing in office jobs, reports that activity has been very quiet in recent weeks, though the environment is difficult to gauge during this typically slow hiring season; however, a further large increase is noted in the number of people looking for jobs—in particular, people recently let go from financial firms, notably hedge funds.

Financial Developments

Bankers report continued weakening demand for loans in all categories, though to a lesser extent than in November. The one segment in which declines in loan demand are increasingly widespread is in non-residential mortgages. For the first time since last Spring, more bankers indicate increases than decreases in home refinancing activity: 33 percent report an increase while 14 percent report a decrease. Banks continue to report widespread tightening in credit standards across all loan categories. Respondents, on net, note some decline in the spreads of loan rates over cost of funds for the residential mortgage loan category. For all other loan categories, however, bankers report little or no change in spreads. Banks also report widespread declines in average deposit rates. Finally, bankers report increased delinquency rates for all loan categories—most notably in the consumer loan and residential mortgage categories, where the proportions of bankers reporting increased delinquencies reached record highs of 57 percent and 49 percent respectively.

THIRD DISTRICT – PHILADELPHIA

Business conditions in the Third District remained soft in December. Manufacturers, on balance, reported declines in shipments and new orders. Retailers indicated that sales were far below the level of a year ago, and motor vehicle dealers reported continued sluggishness in sales. Bank loan volume rose slightly in December, but credit quality continued to deteriorate. Residential real estate sales and construction remained on a declining trend. Commercial real estate investment and construction activity continued to be slow. Service sector activity generally declined during December. Business firms in the region reported decreases in input costs and output prices in December, and retailers made extensive markdowns for the holiday shopping period.

The outlook among Third District businesses is generally pessimistic. Manufacturers forecast decreases in shipments and orders during the next six months. Retailers expect a slow sales pace during the winter. Auto dealers do not expect much improvement in sales. Bankers anticipate slow loan growth during the year. Residential real estate agents and home builders expect sales to remain slow at least until mid-year and possibly longer. Contacts in commercial real estate expect leasing and construction activity to remain at low levels until overall economic conditions improve. Service sector firms expect activity in 2009 to be slower than in 2008.

Manufacturing

Third District manufacturers reported continuing declines in shipments and new orders, on balance, from November to December. Nearly one-half of the manufacturers surveyed noted decreases in those measures, and around one-fourth reported increases. Reports of declining demand exceeded reports of rising demand in all the major manufacturing sectors in the region except food processing. The drop in orders continued to be especially large for firms that manufacture construction-related goods and materials and business and industrial equipment. One maker of industrial machinery said, “Customer capital budgets are being dramatically reduced,” and several producers of metal products noted order cutbacks and extensions of delivery dates by customers.

The outlook among Third District manufacturers remains generally pessimistic. Among firms polled in December, a little more than one-third expect new orders and shipments to

decline during the next six months, and less than one-third expect increases. Area manufacturers continued to cut capital spending plans, and the number of firms planning to reduce future outlays increased from November to December.

Retail

Third District retailers generally reported year-to-year declines in sales in December. Customer traffic and sales were generally far below year-ago levels despite several days of extended opening hours and widespread discounting during the month. Sales of jewelry and apparel were especially weak, according to retail contacts. They also said that discount stores were generally the only retailers that achieved year-to-year increases in sales. Despite the disappointing results, most stores were not left with excessive inventories. Discounting early in the season shifted sales to early December and reduced the amount of post-Christmas buying, but conservative stocking by stores generally resulted in “a little less merchandise on the shelves on December 26,” according to one store executive. The outlook among the region’s retailers is not positive. Many anticipate a prolonged period of retrenchment by consumers, and they expect a significant number of retail firms to close some of their stores or cease operations entirely during 2009.

Third District auto dealers reported a continuing slow rate of sales in December. They said a reduction in financing for car purchases was seriously limiting sales. Dealers also reported difficulty obtaining inventory financing. Looking ahead, they expect some improvement in sales if banks and finance companies increase financing for car buyers, but they expect more dealers to go out of business unless sales move up significantly from the recent pace.

Finance

Total outstanding loan volume at Third District banks rose slowly in December, according to bankers contacted for this report. There have been gains in real estate loans and consumer credit but no growth in business lending. One banker noted that “Companies are shrinking operations and need less financing.” Other bankers said that consolidation among large banks with branches in the region has been attended by a slowdown in those institutions’ business loan marketing efforts. Most of the banks contacted for this report said that credit quality continued to decline for both business and personal loans. Banks polled in December

generally reported steady deposit growth and adequate liquidity. Looking ahead, bankers expect slow expansion in lending in 2009, although some said growth in lending could get a boost from new relationships with firms and nonprofit entities that are turning to banks in lieu of capital markets for funding.

Real Estate and Construction

Residential real estate activity in the Third District continues to weaken. Residential real estate agents and builders reported that sales remained on a downward trend. Although the number of homes for sale has edged down, time on market has increased. Real estate agents noted that many prospective buyers are making low bids for houses and asking for further price reductions after signing sales agreements. One agent said that “We are seeing a lot of sellers renting their homes because they are not prepared to accept what buyers are willing to offer.” In general, real estate agents said average selling prices continued to fall in most parts of the region, and that price declines have been more widespread in the higher price ranges. Builders and agents expect current market conditions to persist at least until the spring, and many believe improvement might not take hold until 2010.

Commercial real estate firms indicated that construction, leasing, and purchase activity continue to fall, and project postponements continue to be announced, especially for retail-oriented development. Although some new office and hotel projects have been proposed in the region, contacts do not expect commercial real estate investment and construction activity to pick up until general economic conditions improve and tenants commit to occupy new buildings.

Services

Service sector firms generally reported lower levels of activity in December compared with November. Some business services firms indicated that their client firms were reducing their use of outsourced services because their own activity has slowed and as part of their general efforts to reduce operating expenses, especially for non-essential functions. Business and professional service firms noted that prospective clients are increasingly focused on immediate cost-reducing or revenue-enhancing benefits of purchased services. Firms providing many types of personal services reported slower business and declining revenue as a result of declines in both the number and dollar value of transactions. The outlook among area service firms has

weakened since the last Beige Book, and several of those contacted for this report are planning for reduced activity in 2009.

Prices

Reports on input costs and output prices indicate a further general decline since the previous Beige Book. Manufacturing firms continued to note decreases in commodity prices for the materials they use, and a growing number have reduced the prices of their own products. Retailers generally reported steep markdowns for the holiday sales season, and many implemented further discounting in the days after Christmas.

FOURTH DISTRICT – CLEVELAND

Economic activity in the Fourth District weakened further during late November and December. The downward trend in factory output and steel shipments that began in the middle of the third quarter continued. Residential construction remains very weak, with no improvement expected during 2009. Commercial builders are experiencing declining backlogs and a fall-off in inquiries. Sales by District retailers were characterized as flat to down, while purchases of new and used cars continued to fall. Business and consumer loan activity has weakened, while core deposits were stable to increasing. Little change in energy production was noted. And freight transport volume declined across all industry sectors.

Reports show a drop in employment levels, primarily in manufacturing, construction, and freight transport services. Staffing firms reported an overall decline in job openings as well. However, healthcare and defense-related businesses are still hiring. Wage pressures remain contained across all industry sectors. There has been a significant pullback in capital spending by manufacturers, retailers, and freight transport providers, with further cutbacks anticipated during 2009. The downward trend in raw materials prices has started to level off.

Manufacturing. Output at District factories was flat to down during the past six weeks, with several reports indicating double-digit reductions in orders. On a year-over-year basis, production levels declined. Respondents expect demand will remain very soft through 2009. For the most part, capacity utilization is below normal levels. Almost all steel producers and service centers reported a worse-than-expected slump in shipping volume, with several contacts noting that end markets are weak across the board. Our contacts believe that the demand for steel will weaken further during the first quarter of 2009. We also heard several reports that foreign steel producers are beginning to price more aggressively. District auto production declined sharply during November on a month-over-month and year-over-year basis. The declines were felt by both domestic makers and foreign nameplates.

Almost half of our contacts said that their companies have trimmed back or halted capital expenditures during the past couple of months. Further, many of them expect additional cutbacks or a freeze on capital spending during 2009. Several manufacturers told us that they have successfully renewed their credit lines since our last report. However, the agreements contained additional covenants, and the price of credit was higher. Contacts indicated that the downward trend in raw materials prices has started to level off. Product pricing remains relatively stable, with some reductions noted. Looking forward, manufacturers expect little inflationary pressure during 2009. A majority of our respondents said that they have laid-off

contractors and permanent employees. In addition, several companies eliminated overtime and initiated hiring freezes. Wage pressures are contained.

Real Estate. Residential contractors reported extremely weak home sales during the past six weeks; nonetheless, several noted an uptick in Internet and foot traffic. Looking forward, most builders are not expecting an industry turnaround through 2009. Although residential mortgage rates have dropped, banks continued to tighten credit standards and are demanding higher down payments from home buyers. We heard a few reports that banks are very reluctant to finance contractors. Prices for building materials and labor continued to moderate. There has been little change in the list prices of new homes, though builders are discounting. Some contractors reported increased inventories due to take-backs from home sales that fell through, and several builders are now renting out unsold spec houses and condominiums. General contractors and subcontractors reported widespread staff reductions and no wage pressures.

Most commercial builders told us there has been some slowing in construction activity during the past couple of months, and they expect this trend will continue during 2009. Several firms attributed the slowdown to difficulties in financing projects and uncertainty on the part of clients. Backlogs have declined for some contractors, while inquiries have fallen off. Construction material prices remain stable. Builders told us that they are becoming more competitive in their pricing, and some expect margin contraction in 2009. A few general contractors laid off employees, and wage pressures are not an issue.

Consumer Spending. District retailers reported that November sales were flat to down on a month-over-month basis across all industry segments. The sole exception was a national discount chain that experienced increased sales. Two respondents noted a slight pick-up in sales at the beginning of December, reflecting normal seasonal patterns. Retailers had mixed expectations regarding sales during the first quarter of 2009. On balance, vendor prices remained stable since our last report. Accounts from auto dealers show that purchases of new and used vehicles continue to decline. Dealers do not anticipate any improvement until the second half of 2009 at the earliest. A majority of our retail contacts said they plan to cut-back or freeze capital spending during 2009. Other than some seasonal hiring, staffing levels at retail stores were stable. In contrast, several auto dealers said they have cut additional sales and support personnel since our last report. Little wage pressure was reported.

Banking. In general, commercial and industrial lending has been stable to declining. Although banks' benchmark funding rates have been falling, nearly all bankers said that lending spreads are holding constant or widening. This is due in part to several bankers having put in

place a floor under lending interest rates. On the consumer side, demand for installment loans fell, while the use of home equity lines of credit remained solid. There has also been a significant increase in refinancing applications for residential mortgages. Pricing for consumer loans showed little change. Loan standards remained stringent or have tightened further during the past six weeks. A majority of bankers reported that credit quality for consumer and business loan applicants has deteriorated, while the number of loan delinquencies has increased. Overall, core deposits were steady to increasing, with most of the increase attributed to a flight to safety. Staffing levels remain relatively stable; however, several banks are considering staff reductions in 2009 via layoffs or attrition. No wage pressure was reported.

Energy. On the whole, energy production has been stable during the past six weeks. Expectations call for oil and natural gas production to increase during the upcoming months, with some of the increase attributable to typical seasonal fluctuations. Nonetheless, a moderate decline in drilling activity is expected during the first half of 2009. The outlook for coal production is mixed. Reports indicate that the prices received for oil and natural gas continue to fall from their July peaks; however, the downward trend for natural gas has moderated. Energy producers saw little change in materials and equipment costs with the exception of diesel fuel, which has declined. Further, capital spending remains on plan, with little change expected during the next few months. We heard a few reports that coal mine operators are experiencing difficulty obtaining credit. Coal producers reported modest staff expansions, with some additional hiring expected in the upcoming months. Wage pressures that existed during the second half of 2008 have diminished.

Transportation. Freight transport service companies experienced a greater-than-expected decline in shipping volume and revenues. Company officials told us that although weakness exists across all market segments, much of the drop-off is attributed to consumer products, autos, and construction materials. Expectations call for activity to remain very weak through at least the first quarter of 2009. Most transport companies reported pulling back on capital spending during the past few months, with further cutbacks anticipated. Many respondents told us that they are no longer hiring any drivers due to industrywide capacity reductions. As a result, there has been a lessening in driver turnover. Further, office staffing positions are being eliminated, and there were no reports of wage pressures.

FIFTH DISTRICT—RICHMOND

Overview. Reports from business contacts indicated that economic activity in the Fifth District slowed further in recent weeks, with disappointing holiday retail sales, declining activity at District ports, and continued weakness in real estate. Retail sales—including sales of big-ticket items—fell, and although the pace of payroll cuts in retail abated a bit, services firms reported workforce downsizing. District manufacturers noted declines in shipments, new orders, and employment while both import and export activity declined at District ports. In residential real estate, lenders reported an increase in refinancing due to lower interest rates, but home sales were sluggish and contacts described either tightened or unchanged credit standards. Commercial real estate conditions softened as contacts observed little sales activity and virtually no new construction. Meanwhile, temporary employment agents mentioned weaker demand for workers due to economic uncertainty and the reluctance of businesses to invest in new projects.

Retail. Most Fifth District retailers were disappointed by holiday sales this year. For some merchants, the decline accelerated as the holiday shopping period progressed. Contacts also told us that foot traffic was down, though not to the same degree that sales declined. Several retailers also said that in recent weeks more customers paid with cash than with credit cards. The manager at an established metropolitan-Washington, D.C., department store said, "We've had to use more coin (for change) than ever before." In Virginia Beach, Va., a discount store manager reported that customers were paying less than usual per transaction. In addition, most retailers told us that gift card sales were weak compared to previous years' sales. Contacts attributed the slide in retail sales to consumer fears of job loss and anxiety about possible changes to existing credit card agreements. Automobile and light truck dealers continued to report falling sales. A dealer in the Tidewater area of Virginia said his domestic car sales in the last four weeks were the worst he had experienced since the 1970's. Retail payroll cuts continued, but at a slower pace, since our last report. Wage growth held up, while retail price growth moderated.

Services. According to our contacts, revenues contracted sharply at most services firms in recent weeks, although a handful of security businesses and telecommunications firms reported stronger revenue growth. An administrator at a central North Carolina hospital said fewer elective procedures were scheduled in recent weeks, and a large care facility in central Virginia reported increased cost-saving efforts to avoid cutting staff. Executives at financial services firms noted that their clients continued to be wary. In addition, a CPA at a firm just outside Baltimore, Md., told us his small business clients were "feeling the squeeze" of the sagging economy. Services firms generally downsized since our last report. A contact at a North Carolina healthcare system reported a hiring freeze for administrative employees, although his facility continued to hire patient-care personnel. A Virginia airport contact said several empty positions would not be filled, and a contact at a central North Carolina non-profit firm told us that the requirement for a break-even cash flow would likely lead to eliminating additional employees in 2009. Average wage growth slowed at services firms, while price growth edged up slightly.

Manufacturing. District manufacturers reported that the contraction in activity deepened in recent weeks as shipments, new orders, and employment slipped further. A producer of paper products in North Carolina told us that business was down considerably and that they were planning to run only 7-9 days in December instead of the normal 24 days. He indicated that if these conditions continued for the next several months, they might have to close a facility. A furniture maker in North Carolina said that business was down 25 percent since the start of the third quarter and was, at best, tepid in the earlier part of the year. He reported that several suppliers and retailers had gone out of business, and stated that, “this is the worst business since 1982.” Contacts reported that raw materials prices rose at a slightly quicker pace since our last report. A number of manufacturers reported that their margins were compressed due to a growing inability to pass along price increases.

Activity at District ports declined quickly in November and December. Contacts reported reduced levels of import and export containers, and a “precipitous drop” in container rates. On the import side, activity related to construction and household products—such as plywood and furniture—remained notably low. Exports of power-generating products remained the only bright spot at one District port, while used car shipments to the Middle East and Africa were still doing well at another. Despite these instances, contacts reported seeing some scaling back of shipping schedules.

Finance. Residential lenders reported an increase in activity in recent weeks, which they attributed to lower interest rates, after a “dismal” November and early December. Contacts reported a rise in residential refinances, which accounted for 80 percent of applications in some areas of the District. However, purchase applications remained low, and one contact monitoring the region noted that “we haven’t seen the uptick we usually would have with a similar decline in rates.” Credit standards continued to tighten at some institutions, while others reported no change. Lenders noted that more time intensive underwriting and stricter qualifications were preventing some applicants from taking advantage of lower rates. Additionally, contacts noted an increase in clients drawing on home equity lines in recent weeks. In commercial lending, contacts reported stable to lower demand for loans. Lenders remained cautious as they shied away from real estate investment, reduced loan-to-value ratios and heavily scrutinized balance sheets. Reports on credit quality were mixed, with some contacts noting a slight deterioration of clients’ portfolios and others reporting no material changes.

Real Estate. Fifth District Realtors continued to report generally sluggish home sales in recent weeks, although several added that this was typical for the season. A Richmond agent told us that although the lower interest rates had increased affordability, there were still some buyers who remained “on the fence” in anticipation of interest rates dropping even further. He reported an increase in refinancing activity but noted that lenders were being very thorough in evaluating applications, and that appraisers were being careful to value homes based on comparisons with other properties sold in the last few months. Several Realtors reported a rise in inventory and a Realtor in Greensboro, N.C., reported that builders continued to

give major concessions to prospective buyers to boost sales. Agents in Washington, D.C., and Fairfax, Va., told us that the low mortgage interest rates had not only given buyers more buying power but had also spurred investor interest. House prices across the District were reportedly holding steady.

Commercial real estate conditions continued to deteriorate in recent weeks. Assessments of leasing activity across the Fifth District ranged from slowing to “frozen.” Contacts stressed that transactions were taking longer to close due to client indecision and difficult financing conditions. A Roanoke, Va., agent reported that “the few deals that are closing are all taking longer than 180 days to complete, when they usually take 90 to 180 days.” Quoted rental rates were mostly unchanged, although agents in Washington, D.C., and Richmond, Va., believed that rates would be declining if transactions were actually occurring. Vacancy rates crept up across Virginia and the Washington area, but held steady in other District markets. Little sales activity and virtually no new construction were reported. Contacts said that some banks were still financing projects, but with stronger constraints, including higher equity requirements and a greater percentage of pre-leased space.

Tourism. Reports on District tourism were mixed. Contacts along the coast told us that bookings were somewhat weaker compared to our last report and to a year ago, which they attributed to the waning economy. A hotelier at Virginia Beach, Va., said that state-sponsored group bookings were much weaker due to budget cuts in Virginia. Analysts in North and South Carolina indicated weaker holiday bookings and fewer inquiries about Christmas and New Year’s reservations. In contrast, a manager at a ski resort in Virginia told us that his hotel was “packed” during the week between Christmas and New Year’s, crediting the increase to a bout of colder weather which enhanced their snow-making capabilities.

Temporary Employment. Fifth District temporary employment agents reported generally weaker demand for workers in recent weeks, due in part to economic uncertainty and weak business investment. An exception was a Raleigh agent who was optimistic that demand for workers at his agency would improve from its current level as businesses would be planning for the new year. Most agents reported continued difficulty obtaining clients. Demand was strongest for workers with high-level technical skills, workers proficient in common computer software, and workers providing professional and support services.

Agriculture. Above-average precipitation accompanied by below-normal temperatures delayed harvesting activity and hindered crop development in most of the District. Contacts in Virginia reported that excessive rainfall delayed the soybean harvest; approximately twenty-two percent of the crop had yet to be harvested. Other contacts in Virginia indicated that frost and snow had spoiled pastureland as a source of forage and that most cattlemen had switched over to supplemental feed. Furthermore, analysts in Virginia and North Carolina told us that winter wheat had been slow to emerge due to the cooler temperatures and rain in recent weeks. Nonetheless, analysts in South Carolina noted that ample rainfall had improved winter grazing conditions. In addition, small grain planting had been completed in North Carolina and was nearing completion in Maryland.

SIXTH DISTRICT – ATLANTA

Summary. Economic conditions in the Sixth District were weak through December. Holiday sales results were near or below year-ago levels and auto sales were dismal. Further declines in new orders were reported by most manufacturing contacts. Residential real estate contacts described new and existing home sales and construction activity as weak and that average home prices continued to decline in most areas. Commercial contractors also noted ongoing softness in nonresidential construction. Lending standards at District banks remained tight. Labor markets weakened further through the end of the year with contacts across most industries noting additional layoffs and reduced hours. A majority of business contacts reported reduced input prices.

Consumer Spending and Tourism. District retail contacts indicated that holiday sales were generally weak. Contacts said that sales of luxury and big-ticket items were particularly weak, while apparel sales also struggled. Several contacts noted that discounting was deeper and more prevalent this holiday season because of fierce competition in an effort to clear inventories. Discount stores generally fared better as budget conscious consumers shopped for bargains. Looking ahead, weakness is expected to persist in the near term and may result in some retailers closing underperforming stores. Additionally, some businesses indicated that their inability to finance inventory purchases would mean they may close some stores.

District vehicle sales were off sharply in November and December. Contacts cited both tight consumer credit and overall lower demand as contributing to the weakness. Dealers across the region are reportedly cutting advertising and payrolls to cope with the current business climate.

Tourism activity was mixed from mid-November through the holiday season. Florida appeared to benefit from the usual influx of winter residents, but contacts report that overall visits to the state were below year-ago levels. Nonetheless, aggressive promotions and cheaper gasoline prices appeared to boost travel in to several Florida destinations.

Real Estate and Construction. Reports from homebuilders and Realtors indicated that new and existing home sales were weak from mid-November through December, with most noting that overall sales were down significantly compared with the

already low levels of a year earlier. District homebuilders continued to pull back on home construction. New home inventories declined in Florida and Georgia, according to contacts, while elsewhere in the District the number of new homes on the market increased somewhat. Existing home inventories remained at high levels. Home prices continued to soften in the District; contacts indicated that the large volume of foreclosed properties for sale was exerting downward pressure on both new and existing home prices. According to District contacts, the near-term outlook for residential sales and construction activity remains weak.

Most District commercial contractors continued to report declines in activity, and more projects were cancelled or postponed. Going forward, commercial real estate contacts anticipate more space will become available and rents will soften, particularly in the retail sector.

Manufacturing and Transportation. A majority of manufacturing contacts noted that production and new orders remained below year-ago levels. Export orders also declined – a sharp change from earlier in 2008 when exports were expanding. Production is expected to remain sluggish according to manufacturing contacts.

Most transportation service firms reported weak freight demand and excess shipping capacity in November and December. Shipments of retail, automotive, and construction-related goods, as well as inter-modal cargoes were reported down sharply from a year earlier, with only coal and minerals posting small gains.

Banking and Finance. According to most banking contacts, District lending conditions continued to tighten during mid-November and December. Lending standards have been raised and loan covenants strengthened, making it harder for some banks to find customers with financial positions strong enough to qualify for loans. Worsening economic conditions caused banks to restrict lending to specific industries. Especially hard hit were those segments related to the housing and the automobile industries. Banks also appeared less willing to take on new commercial projects and instead focused on serving their existing customers.

Employment and Prices. Employment conditions in the District weakened through the end of the year, with numerous accounts describing hiring freezes, layoffs and reduced hours in December. Weakness was fairly widespread.

Most District contacts reported reduced input price pressures. Manufacturers reported that prices for both raw materials and finished goods were below year-ago levels and are expected to decline further in the short term. Even as input price pressures have eased, some businesses noted falling profit margins because of the need to discount output prices.

Natural Resources and Agriculture. Weather conditions were favorable for fieldwork, and most areas received moderate rainfall during November and December. Apart from northeast Georgia, severe drought conditions abated in the Sixth District states. The moderation in fuel and fertilizer costs is expected to improve the near-term financial outlook of some agricultural producers. Poultry exports slowed in response to lower foreign demand.

According to contacts, oil and gas exploration companies scaled back operations and re-evaluated expansion plans in response to lower oil prices and difficulty obtaining financing.

SEVENTH DISTRICT—CHICAGO

Summary. Economic activity in the Seventh District declined further in December, with contacts noting lower consumer and business confidence. Consumer spending decreased and labor market conditions weakened. Construction declined, and manufacturing activity moved lower. Credit conditions remained tight, but improved in some markets. Contacts reported increased concern with expenses given declining economic activity and rising uncertainty over the economic outlook. In agriculture, field work was limited in December by bad weather.

Consumer spending. Consumer spending decreased in December. Despite heavy discounting, retailers reported declines in sales, particularly for clothing and big-ticket and luxury items such as electronics, appliances, and jewelry. However, discount stores fared better than their higher-priced counterparts. Tourism activity in the District also slowed, with hotel occupancy down in December. Auto dealers again reported declining sales, while service center activity continued to be robust. Sales were sluggish for Detroit three nameplate vehicles. According to some of our contacts, this weakness reflected the uncertainty surrounding the future of these automakers. However, several contacts indicated that the recent declines in gas prices had stimulated demand for light trucks. Dealers were also reportedly closely monitoring inventory to avoid paying end-of-year fees on unsold vehicles.

Business spending. The pace of business spending declined further from the previous reporting period. Several contacts reported scaling back or putting on hold capital spending plans given the uncertainty surrounding the economic outlook. Labor market conditions in the District also weakened. Layoffs were reported in financial services and several manufacturing industries, including a number of automotive suppliers. Several manufacturing contacts also noted reductions in hours worked. The government, education, and healthcare sectors continued to expand employment. However, growth in the latter two also began to show signs of slowing in parts of the District. The demand for skilled labor remained strong, but a contact noted that many applicants lacked the skills necessary to fill available jobs. Recruitment activity stabilized in December after declining sharply in November.

Construction/real estate. Construction activity declined in December. Residential building continued its steady decline. Developers remained cautious to expand inventory levels given persistent weakness in showroom traffic and elevated cancellation rates. Several contacts noted excess capacity in the condo market. Mortgage applications rose significantly, particularly for

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refinancing, spurred by declining mortgage rates. Mortgage originations continued to be low with many potential borrowers unable to meet the more stringent lending standards put in place in 2008. Nonresidential construction also declined. The availability and cost of financing continued to be of concern for commercial developers, with additional cancellations and project delays reported. Contacts noted elevated vacancy rates, increases in sublease space, and continued downward pressure on commercial rents.

Manufacturing. Manufacturing activity in the District decreased from the previous reporting period with several contacts reporting lower orders and production cuts. Activity in the domestic steel industry slowed further as production was scaled back amid declining demand. However, a contact noted that a future increase in demand may come from service centers where inventories remained low in December. Other metals-related industries also noted softening conditions. Demand weakened further for heavy machinery and medium- and heavy-trucks. A contact noted that agricultural equipment dealers were able to offer spring delivery dates on farm equipment that had been previously fully booked into 2009, as cancellations increased and exports waned. Exporters reported that demand from abroad continued to slow. A few contacts reported tight credit conditions negatively impacted the demand for their products. In addition, a contact noted that some manufacturers have begun to ask for deposits on orders to reveal the true extent of future demand for their products.

Banking/finance. Credit conditions in the District remained tight. The demand for liquidity continued to be high in December. Credit risk concerns persisted and borrowing spreads remained elevated. Banking contacts reported continued weakness in loan demand, as nonfinancial firms reevaluated capital spending plans given the uncertainty surrounding the economic outlook. Consumer auto lending remained tight, but a group of regional credit unions and GMAC both announced efforts to revive lending during the reporting period. Liquidity in the secondary residential mortgage market was noted to have improved after the Federal Reserve's announcement of its intent to purchase agency debt and mortgage-backed securities. Loan quality continued to be of concern for residential real estate loans. Contacts also noted retail trade and firms with heavy exposure to volatile commodity prices as sources of potential risk to quality. In addition, several contacts in commercial real estate finance pointed to potential further deterioration in quality as variable interest rate loans come due for refinancing this year.

Prices/costs. Contacts reported increased concern with expenses given declining economic activity and rising uncertainty over the economic outlook. Despite recent further declines in

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material and energy prices, some contacts continued to report pressure on costs remained. However, others noted the benefits of lower food and energy prices on margins. In retail trade, downward pressure on prices intensified during the holiday shopping season, leading to tighter margins as retailers were unable to pass on increases in costs from wholesale prices. Wage pressures were limited. However, several contacts noted that firms were choosing to freeze or cut pay instead of laying off workers to lower labor costs. In addition, contacts also reported that firms were reducing or eliminating elements of non-wage compensation.

Agriculture. Fall field work was limited in December by the weather. In addition, farmers had an incentive to wait until the spring as fertilizer prices began to fall from very high levels. A portion of farmers had already locked in fertilizer orders at high prices, but some only put down modest deposits. Corn and soybean prices rebounded toward the end of the reporting period, after declining into December. Even so, farmers tended to hold onto crops rather than sell them. At current crop prices and given higher input costs for corn planting, District farmers favored planting more soybean acres and fewer corn acres this spring. Farmers were considering other options for planting rotations as well, in case corn and soybean prices failed to move higher. Contacts expected more renegotiations to lower cash rental rates, since 2009 net farm income was expected to decline from 2008. Operating loans remained available for agriculture to meet higher demand due to increased input costs from a year ago. Hog prices edged up in December, which, combined with lower feed costs, allowed for an improvement in margins. Milk and cattle prices were down.

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Eighth District - St. Louis

Summary

Economic activity in the Eighth District has continued to decline since our previous report. Manufacturing activity weakened further and the services sector contracted. Residential real estate market activity continued to decrease. Commercial real estate markets have held steady but commercial and industrial construction activity has softened. Overall lending at a sample of small and mid-sized District banks declined during the three-month period from mid-September to mid-December.

Manufacturing and Other Business Activity

Manufacturing activity has continued to decline since our previous report. Several manufacturers reported plans to close plants and reduce operations in the near future, while a smaller number of contacts reported plans to expand operations. Several firms announced job layoffs in the face of ongoing and projected weak demand. Firms in the plastics, furniture, paper, animal slaughtering/processing, automotive parts, electrical equipment, food, footwear, and railroad car manufacturing industries reported plans to close plants in the District, resulting in a significant number of job losses in these industries. Contacts in fabricated and primary metal, electrical equipment, and automotive parts manufacturing reported plans to lay off workers. Several large projects for the auto industry were put on hold and production was halted because of demand uncertainty. In contrast, firms in sugar manufacturing, machinery manufacturing, and other transportation manufacturing announced plans to open new plants in the District and hire additional workers. Firms in the plastic products and chemical products ended job strikes and signed new labor contracts, while firms in furniture manufacturing benefited from a new foreign-trade zone designation

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The District's services sector reversed the gains from our last report, with several major employers announcing large job cuts. Contacts in business support services, information services, and engineering services reported large layoffs and salary reductions. Firms in educational services, information services, leisure/hospitality services, and several firms in transportation services also reported plants to consolidate operations and lay off workers. In contrast, a few small firms in business support services reported job growth and a contact in one small private firm in education services expressed optimism about growth in 2009. General retailers reported lower sales in the fourth quarter of 2008 compared with a year ago, particularly among stores that specialize in electronic goods or home furnishings. Auto sales in the fourth quarter of 2008 were down compared with the same period last year, and several dealerships closed while others reported a negative outlook for 2009.

Real Estate and Construction

Home sales continued to decline throughout the Eighth District. Compared with the same period in 2007, November 2008 year-to-date home sales were down 15 percent in St. Louis, 19 percent in Memphis, 22 percent in Little Rock, and 23 percent in Louisville. Residential construction also continued to decline throughout the District. November 2008 year-to-date single-family housing permits fell in nearly all District metro areas compared with the same period in 2007. Permits declined 35 percent in Little Rock, 42 percent in Louisville and St. Louis, and 58 percent in Memphis.

Commercial real estate markets seem to be stable throughout the District but commercial and industrial construction is slowing. Contacts throughout the District reported that office and industrial leasing is expected to remain steady through the first half of 2009. A contact in Louisville noted, however, that any automobile plant closings could quickly change the leasing

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environment in that area. Commercial and industrial construction contacts throughout the District predict a challenging environment in early 2009. Construction activity in the Memphis metro area has seen a slowdown throughout most of 2008 and is expected to remain soft in 2009. In particular, Shelby County, Tenn., has had no new industrial construction since late 2007 and no new industrial construction is expected for DeSoto County, Miss., in 2009.

Banking and Finance

Total loans outstanding at a sample of small and mid-sized District banks decreased 1.4 percent from mid-September to mid-December. Real estate lending, which accounted for 73 percent of total loans, decreased 2.0 percent. Commercial and industrial loans, accounting for 17.3 percent of total loans, increased 0.6 percent. Loans to individuals, accounting for 5.2 percent of loans, increased 0.6 percent. All other loans, which accounted for 4.5 percent of total loans, decreased 1.4 percent. Over the same period, total deposits at these banks decreased 3.0 percent.

Agriculture and Natural Resources

As of mid-December, year-to-date bales of cotton ginned (separated from the seed) in the District states were down by 30 percent over the same period in 2007. Arkansas had 32 percent fewer bales ginned than the previous year, Mississippi had 48 percent fewer, and Missouri and Tennessee each had 11 percent fewer. Total commercial production of red meat in the District states decreased by 7 percent in November over year-earlier levels. In November 2008, the total weight of young chickens slaughtered was 12 percent lower than November 2007. Total coal production in the District states was 3 percent higher in December 2008 than December 2007, while total coal production in 2008 was the same as 2007.

NINTH DISTRICT--MINNEAPOLIS

Ninth District economic activity decreased slightly in most sectors since the last report. Decreased activity was noted in consumer spending, tourism, services, construction and real estate, manufacturing, energy, mining and agriculture. Labor markets continued to weaken, as a number of companies announced layoffs since the last report. Overall wage increases were modest. A number of prices continued to decrease since the last report, but the pace of decline seems to have stabilized.

Consumer Spending and Tourism

Holiday sales were down somewhat in a number of areas. Contacts in Montana reported decreases in sales ranging from 5 percent to 40 percent, but grocery store sales were at least level with last year. A mall manager in Montana noted that December sales were down from last year – the first year-over-year decrease in more than 20 years. A bank director noted that retail sales in South Dakota were up slightly during the holiday season, but deep price discounts ate into profit margins. A representative of a Minneapolis-area mall noted that traffic was slower than typical during the early and middle parts of the holiday shopping season, but it picked up toward the end. Meanwhile, a representative of an auto dealers' association in South Dakota reported that recent vehicle sales were down substantially.

Tourism activity was down slightly from a year ago. A ski resort in northeastern Minnesota reported that visit numbers through the holidays were down from a year ago. Convention and conference business in the St. Paul area has trended downward since last fall, while tourism activity was down slightly from a year ago in Duluth, Minn. Snowmobiling and ice fishing activity was relatively strong in northwestern Wisconsin, according to a chamber of commerce representative, but business at restaurants was slow.

Services

Activity in the services sector decreased since the last report. Slow activity was reported by contacts from the legal, architectural and information technology areas. Medical service contacts reported mixed conditions, with services for the aging increasing but elective procedures decreasing.

Construction and Real Estate

Commercial construction declined. The value of commercial permits fell significantly in Sioux Falls, S.D. Severe cold and snowy conditions hampered construction activity.

Residential construction remained quiet. A contact reported that home building activity in the Bozeman, Mont., area was slow. November new home permits in the Minneapolis-St. Paul area were down about 30 percent from a year earlier. In the Kalispell, Mont., area, where the housing sector had been strong until recently, November permits were down 26 percent from a year ago.

Commercial real estate activity decreased. A representative of a Minneapolis-based commercial real estate firm said that the market remains in a downturn that has now lasted over a year; a different firm reported increasing office and industrial vacancy rates. Several areas in the district saw increased retail vacancy, with further store closings expected. While remaining slow, the residential real estate market showed signs of increased activity. An association of Realtors in Minneapolis-St. Paul noted that the number of sales in late December increased from year-earlier levels, driven by foreclosures and short sales, but significantly lower home prices kept dollar volumes down. Realtors in Fargo, N.D., and Sioux Falls noted that lower mortgage rates seem to be spurring some buyers into action.

Manufacturing

Overall manufacturing was down from the last report. A December survey of purchasing managers by Creighton University (Omaha, Neb.) indicated significantly decreased activity in Minnesota and South Dakota, but slightly increased activity in North Dakota. Numerous manufacturing companies reported weakened demand and expected to reduce capital spending and employment. An aluminum maker in Montana announced plans to stop production. However, some defense contractors and medical device companies reported increased manufacturing activity.

Energy and Mining

Activity in the energy and mining sectors decreased since the last report. Late December oil and gas exploration declined from late November. Meanwhile, most iron ore mines in the district decreased production and expect a big reduction in output in 2009 from 2008 levels. Several mine operators in Montana were worried about lower metals prices and reduced demand.

Agriculture

Agricultural conditions deteriorated since the last report. Extremely cold weather and higher than normal snowfall stressed cattle. A Montana cow and calf operator reported

that cattle needed increased levels of feed and water. A South Dakota feedlot reported some deaths due to the frigid weather. However, the frozen ground allowed farmers to progress on the late harvest.

Employment, Wages and Prices

Labor markets continued to weaken, as a number of companies announced layoffs since the last report. In Minnesota, a major manufacturer recently announced more than 2,000 job cuts companywide, a water filtration manufacturer announced 1,600 job cuts companywide, a supplier of suspension assemblies for disk drives will lay off about 1,000 employees and an airplane manufacturer laid off 500 employees in December. Due to decreases in orders during the fourth quarter, a Minneapolis-based spray and fluid equipment maker will cut 150 jobs and a company that makes street sweepers and large floor-cleaning machines will cut 240 jobs. A number of health care providers have announced layoffs in the Minneapolis-St. Paul area, although demand for health care workers remains in some areas. Many more prospective workers are applying for open positions compared with a few months ago in Montana. Job postings at a workforce center in northwestern Montana were at historically low levels, according to the center's manager. A South Dakota credit card services firm announced 50 layoffs. A temporary staffing agency survey of Minneapolis-St. Paul businesses showed that 14 percent of respondents expected to hire workers during the first quarter, while 10 percent expected to reduce staff.

Wage increases have remained modest. Wages for manufacturing workers in district states increased 2.6 percent for the three-month period ended in November compared with a year earlier.

A number of prices continued to decrease since the last report, but the pace of decline seems to have stabilized somewhat. Prices for a number of metal-based products, including copper and steel, decreased since the last report. A bank director noted that scrap aluminum prices have dropped 50 percent during the past few months. Minnesota gasoline prices at the end of December were \$1.40 less per gallon than a year ago. While phosphates and other agriculture-related chemicals have decreased in price since the last report, they remain well above year-ago levels.

TENTH DISTRICT - KANSAS CITY

Economic activity in the Tenth District deteriorated in December. Consumer spending weakened, and expectations for future spending declined further. Manufacturing activity dropped sharply, and both commercial and residential real estate activity continued to contract. Energy activity decreased markedly in response to falling natural resources prices. Contacts lowered expectations for future farm income, but growing conditions in the agriculture sector improved. Bankers reported increasing deposits, declining loan demand, and deteriorating loan quality. Prices continued to fall for raw materials and, to a lesser extent, finished products. Labor market conditions weakened further, leading to fewer wage pressures and lower salary increases for 2009.

Consumer Spending. Consumer spending was generally down in December, and expectations fell across all sectors for the months ahead. Retail sales were lower than last year, and contacts reported that heavy discounting cut profit margins at many stores. Sales were especially weak for large-ticket durable goods, jewelry, and high-end merchandise. Retail and mall contacts anticipated sluggish sales in the coming months. Auto sales weakened from the previous period, and all contacts expected further contraction in the months ahead. Inventory levels were unchanged since the last survey, but most auto dealers said inventories were still too high. Auto credit tightened further, and dealers struggled to obtain financing for buyers. Travel and tourism activity declined in December, with one contact noting a pullback from foreign travelers. Hotels in the mid- and lower-tiers fared better than upscale properties. Restaurant sales improved from the previous survey but were still lower than year-ago levels. Restaurant contacts anticipated less traffic in the next three months.

Manufacturing and Other Business Activity. Manufacturing and other business activity weakened during the latest survey period. Overall, production fell across all types of manufacturing. Plant managers also reported declines in shipments, new orders, and order backlogs. Firms continued layoffs, and many shortened the length of the average employee workweek. Companies with ties to the automotive and railroad industries experienced the greatest number of layoffs. Expectations for future factory activity remained pessimistic, and

plants cut their capital spending plans sharply. Firms anticipated lower production, fewer shipments and a smaller number of new orders in the months ahead. Export orders fell further, and firms remarked that they could no longer rely on foreign markets. Transportation services activity slowed during December and was expected to be flat over the next few months. Firms cut back on capital spending, and one trucking firm said that it was driving more empty miles. Another trucking company said that for the first time in two years it had enough qualified drivers.

Real Estate and Construction. Residential and commercial real estate activity slowed further in December. Home sales decreased from the last survey period, and contacts expected sales to be flat in the coming months. Home inventories were unchanged since the previous survey and were close to year-ago levels, though still quite elevated. Prices continued to drop, and expectations of lower prices in the future were common. Mortgage lenders reported an increase in home refinancings in response to lower interest rates. Commercial real estate activity declined across all segments: office, retail, hotel, and industrial. Contacts expected depressed prices, higher vacancy rates, and lower absorption rates. Rental rates also fell considerably, with levels well below a year ago.

Banking. Bankers reported a decline in loan demand, deterioration in loan quality, and increase in deposits since the last survey. The net fraction of banks reporting lower overall loan demand was about the same as in the previous survey. Demand fell for commercial and industrial loans, commercial real estate loans, and consumer installment loans. However, demand for residential real estate loans was unchanged following significant declines in the previous two surveys. Compared to the last survey, there were more reports of tighter standards on commercial and industrial loans but fewer on residential real estate loans. Tighter standards were particularly prevalent for commercial real estate loans. Assessments of current loan quality were little changed from the last survey, but expectations for future loan quality declined further. Just over half of respondents reported increases in deposits. A few banks said maintaining margins between interest income and interest expense was becoming more difficult with interest rates falling so sharply.

Energy. Energy activity slowed dramatically in December as oil and natural gas prices continued to fall. Almost all contacts reported a decrease in drilling activity over the last month, and all contacts expected activity to continue to decline over the next three months. The number of active drilling rigs in the District fell during the latest survey period and reached the lowest level since late 2005. Furthermore, oil and gas firms were cutting their capital spending budgets and other costs due to the fall in energy prices. Most contacts believed that the downturn in prices was demand driven, but they were somewhat hopeful that demand for natural gas and other heating products would support activity during the winter months.

Agriculture. Agricultural growing conditions improved in December, but farm income expectations weakened. The winter wheat crop was reported in good condition due to adequate fall moisture, and corn and soybean prices rebounded slightly from harvest-time lows. But with commodity prices well below summer highs, rents and prices for cropland eased, although they remained well above year-ago levels. Farm input costs eased slightly with lower fuel and fertilizer costs. Despite reduced feed costs, however, the livestock sector continued to struggle with waning global demand for meat products. Farm income expectations weakened further, and District contacts reported a reduction in capital spending. The availability of funds for agricultural loans held steady while collateral requirements increased further.

Wages and Prices. Price pressures continued to ease, and wage pressures also diminished in December. Raw materials prices fell sharply, and manufacturers in general reported a corresponding decline in finished product prices. Trucking contacts also reported that input prices, including fuel, continued to fall from the record highs of the summer. Retail and restaurant contacts lowered prices and anticipated further declines in the months ahead. Labor shortages were minimal, and wage pressures diminished. The number of contacts expecting to hire additional workers in the next few months fell drastically. One contact commented that projected salary increases for 2009 were the lowest since 2001. Many contacts trimmed labor costs by reducing their workforce, eliminating overtime, shortening the workweek, and lowering bonuses.

ELEVENTH DISTRICT—DALLAS

Economic conditions in the Eleventh District continued to weaken from mid-November to year-end 2008. Contacts across a broad range of industries noted reduced demand and uncertainty about the outlook. Manufacturing, commercial construction, energy and transportation services generally reported the largest drop in demand while residential construction remains at low levels. Accounting and legal services seemed to hold up the best although they reported that demand was flat to slightly down. Bank lending declined due to tighter credit and weaker loan demand. Most respondents don't expect conditions to improve until the second half of 2009 with a growing number of respondents now looking at early 2010.

Prices. In general most service firms reported no change in prices while most goods producers reported declines. Many manufacturing respondents noted that while energy costs have come down, lower capacity utilization rates have put upward pressure on per unit production costs. Retailers reported large discounts were needed to move merchandise over the holiday season. Many contacts reported that fuel surcharges for transportation that were instituted earlier in 2008 were being dropped.

Light sweet crude oil fell to \$37 per barrel by year-end, the lowest price since 2004, from \$55 per barrel in mid-November. Contacts said a huge over-supply of crude oil driven by the US and global slowdown led to the decline and that consecutive cuts by OPEC were not sufficient to stem the decline. Oil product prices fell as fast as crude oil, leaving refiner margins weak. On-highway prices for both gasoline and diesel fell by about 50 cents per gallon since the last survey and natural gas prices declined by about a \$1 per Mcf from \$6.50 per Mcf in mid-November.

Labor Market. Labor markets remained weak as most contacts reported that they had maintained or reduced employment since the last survey. Labor markets were weakest in manufacturing where many firms extended temporary plant closings or reduced operating hours. Many manufacturing contacts reported that they had laid off temporary or hourly workers and that they are likely to reduce full-time staff at the start of the year. Layoffs were becoming widespread in the energy industry, and they are expected to grow in 2009. Many contacts reported hiring freezes and reported little if any wage increases.

Manufacturing. Most manufacturing contacts reported declines in demand and reductions in capacity utilization. Most contacts said that they have managed to keep their inventories at desired lean levels but an increased number of contacts reported that inventories had risen to higher than desired levels.

Construction-related manufacturers reported continued declines in shipments and orders even after adjusting for normal seasonal reductions. Most producers reported reductions in jobs and expect further cuts in early 2009. Some contacts noted that the recent plunge in commodity prices provided only slight relief in the cost of production since capital costs per unit of output have increased as capacity utilization has declined and because pricing on rail and truck transportation and coal have not fallen due to long-term contracts. Contacts continue to report that demand from

commercial construction is shrinking rapidly with the main exception being government sponsored projects. Contacts reported that the outlook has gotten worse and most do not expect a turnaround until late 2009.

Most respondents in high-tech manufacturing industries report that demand has fallen moderately since the last survey. Weakness was widespread across global markets and products. Most firms said that they were planning to reduce employment over the next several months. Respondents reported lean inventories, although one respondent said the recent reduction in demand from Asia had caught them off guard and that they were working aggressively to reduce inventories. While one respondent noted that their factories were running at only 40 to 45 percent of capacity, another respondent said that the current downturn is not nearly as bad as the high-tech recession in 2001. Most respondents expect some improvement in demand sometime in the second half of 2009.

Paper manufacturers reported continued declines in production and orders. Demand for corrugated paper used for boxes and packing material has fallen sharply. Contacts noted that this is a reflection of the overall weakness in manufacturing as producers of a wide range of products are shipping less output. Noted exceptions to the weakness are food processors, where contacts suggest that their industry remains recession-proof.

Respondents reported that while margins for gasoline were particularly weak, refinery capacity utilization held steady at about 85 percent. Respondents in petrochemicals and derivative plastics said that demand and prices have fallen sharply since the last survey. The decline in demand stemmed from declines in domestic housing, autos, and general manufacturing activity, as well as export markets. At least 10 large plants have shutdown on the Gulf Coast in recent weeks, and others have cut runs. Layoffs have been widespread among firms and their contractors.

Retail Sales. Almost all retailers reported weak holiday sales. The weakness was broad-based and included discount stores. One contact noted that it was the worst holiday season for his company in 38 years. Weakness was broad-based across department store products but contacts noted particularly sharp declines in demand for jewelry and men's clothing. A contact with stores throughout the District said that year-over-year sales declined the most in Dallas and the least in Houston. Department store contacts expect demand to be weak throughout most of 2009.

Auto dealers report that sales and traffic continue to fall from already depressed levels. While domestic brands have been hit the hardest, contacts report that recent declines have been broad-based across all vehicle brands. Respondents report that manufacturer incentives are ample but that they are not having as much impact as in the past. One respondent said that in order to reduce his inventory, he likely will not order any new vehicles until February. A bright spot is used car sales and repair services which have increased slightly since the last survey. Most contacts expected very weak new vehicle sales at least through the first half of 2009. Contacts are hoping for some improvement in the second half of the year but are cautious since the outlook remains very uncertain.

Services. Staffing firms report that demand remains sluggish. Most contacts report that there is little demand for permanent hires. Although their customers are keeping many short-term contract positions, they are not adding new positions. Contacts said that demand has been reduced by temporary plant closings, many of which have been

extended due to weak demand conditions. Contacts report that some staffing firms are beginning to lower rates to remain competitive and retain market share.

Accounting and legal firms report that activity was flat to slightly down since the last survey and that receivables are getting slower and harder to collect. Legal firms reported new real estate projects have dropped off sharply and that many projects are being put on hold for an indefinite period of time. International business has also declined. Offsetting this has been an increase in litigation and bankruptcy services.

Airlines report that demand continues to weaken and that it is likely to continue to fall over the next six months. Respondents in container cargo and intermodal trade report a sharp drop off in activity since the last survey due to declines in international trade volumes. Intermodal transport services also noted a decline in demand. Shipping companies reported that the largest declines in volumes have been to retailers although consumer shipments have also weakened.

Construction and Real Estate. Housing conditions in the District remain very weak, according to respondents. Home sales have fallen considerably since credit conditions tightened, and respondents report that traffic remains nearly nonexistent. Contacts reported that cancellations remain prevalent, in some cases outpacing sales. Median home prices have edged down but have avoided the double digit declines prevalent in other areas of the country. Respondents say that compared to other areas in which they do business, Texas continues to fare better despite the poor conditions.

District respondents said apartment demand fell over the survey period. New construction added units at the same time move-outs increased, leading to increases in vacancy rates. Commercial real estate transactions--both leasing and investment--have ground to a halt. Contacts reported "nothing is going on". Outlooks remain uncertain, although one contact noted scattered signs of optimism, with people talking of possible opportunities in 2009.

Financial Services. Financial services contacts in the District continued to report a slowdown in loan demand. Contacts reported that real estate deals were basically nonexistent except for the very low risk ones. Most contacts have seen a slight deterioration in credit quality, but quality is still stable overall. On some loans, contacts have increased the interest rate by methods such as basing spreads off the LIBOR rather than the prime, and setting a floor on the prime.

Depository institutions report maintaining tight credit standards, and most report generally stable deposits. The slowdown in loan demand has been broad-based. Demand has decreased for mortgages and consumer loans, particularly auto loans and credit card issuance and purchase volume. Real estate lenders are very concerned about 2009 while other lenders expect either flat or very modest growth.

Energy. Oil services and machinery contacts reported that drilling activity has declined in response to lower energy prices. The U.S. rig count slid by 15 percent, or 300 rigs, from the peak in August, with two-thirds of the decline coming in the last six weeks of the year. Texas is down 157 rigs since the peak, and 85 rigs of this decline have come in the last six weeks. Contacts reported that the brunt of the decline is land-based and natural- gas directed.

Relatively expensive shale and tight gas led the upturn, and is now leading the downturn as well. Contacts said that offshore and international activity has held up much better, and should continue to do so, based on sponsorship by companies with a longer-term perspective and much deeper pockets.

Agriculture. The cotton harvest is about 85 percent complete, and yields are lower than expected. Regions in Central Texas are suffering from a severe dry spell. The winter wheat and oats crops and pastureland are in need of rain in most parts of the District. Livestock are in fair condition but supplemental feeding is ongoing due to lack of pasture. Commodity prices have plunged from their earlier peaks but fertilizer prices have not declined as much, leaving farmers with low winter crop prices and high planting costs.

TWELFTH DISTRICT–SAN FRANCISCO**Summary**

Economic activity in the Twelfth District weakened on net during the survey period of December through the beginning of January. Upward price pressures continued to ease overall, largely as a result of declines in the prices of energy and some commodities, and upward wage pressures have largely disappeared. Holiday season retail sales were very sluggish, and demand for services continued to soften. Manufacturing activity dropped significantly on net. Demand for agricultural products generally remained stable, but conditions weakened further for oil extractors. Conditions remained feeble in District housing markets, and demand for commercial real estate continued to fall. Contacts from financial institutions reported very weak loan demand and tight credit availability.

Wages and Prices

Upward pressures on prices eased further during the survey period. Prices for energy and selected commodities, including assorted foodstuffs and selected construction materials, continued to fall. Final prices for a wide variety of retail items were held down by extensive discounting. With few exceptions, contacts reported that they expect upward price pressures in their respective industries to remain very limited or to moderate further during early 2009.

Contacts reported little or no upward pressure on wages. With unemployment rising in most areas, companies have seen an increase in the quantity and quality of applicants for open positions, which limits upward wage pressures. Some contacts also reported that they are implementing or considering wage freezes, which employees appear increasingly willing to accept. Wage gains continued to slow for worker groups that previously had seen rapid growth, notably those skilled in the use of advanced technologies.

Retail Trade and Services

Contacts reported an exceptionally weak holiday sales season. The slowdown in retail sales continued to be more pronounced for traditional department stores, while discount chains fared better as consumers curbed their discretionary spending and focused on necessities. Several contacts described the holiday spending season as the weakest in memory, although some also noted that early expectations for weak sales helped to keep inventories largely under control. Demand weakened further for electronic items, which had been a bright spot earlier in 2008, and also for furniture and household appliances. Demand for new automobiles continued to languish, although falling gas prices spurred slightly improved sales of larger used vehicles, such as SUVs. Unit sales of gasoline remained sluggish, despite the price declines.

Demand for services fell further compared with the previous survey period. Providers of health-care services reported continued declines in activity. For providers of professional services such as advertising, legal services, accounting, and business consulting, demand continued to fall, and contacts noted concerns regarding the ability of clients to pay. Travel activity declined further: contacts from Southern California reported that much weaker demand for hotel rooms has followed recent supply expansions that had heightened the competition for bookings; in Hawaii, tourist visits and spending were down by double-digit amounts relative to 12 months earlier, and hotels and related businesses have been laying off staff.

Manufacturing

District manufacturing activity weakened significantly during the survey period of December through the beginning of January. Sales of semiconductors and other information technology products slowed substantially in recent months, causing capacity utilization to fall and inventories to rise, accompanied with layoffs by some companies. Activity for producers of

wood products remained extremely depressed, with further curtailments in production and employment expected due to the sluggish pace of home construction. Capacity utilization rates at petroleum refineries remained well below their longer-term average. Metal fabricators struggled with very weak demand, which reduced capacity utilization to unusually low levels and forced some companies to impose restricted work schedules. Activity continued at high levels for aerospace manufacturers, although contacts cited uncertainty regarding demand for commercial aircraft and national defense products in coming months. Food manufacturers saw solid demand in general, albeit with some reductions due to scattered business failures among their retail customers.

Agriculture and Resource-related Industries

Demand generally remained stable for agricultural producers but weakened further for oil extractors. Sales continued at a solid pace for most types of agricultural products, while input costs fell, particularly for fuel and fertilizer. Among oil extractors, weaker demand coupled with ample worldwide supply caused inventories to rise and prices to fall, further reducing the economic viability of higher-cost capacity expansion projects.

Real Estate and Construction

Housing market activity in the District remained feeble during the survey period, and demand for commercial real estate fell further. Despite some pickup in recent months, the pace of home sales continued to be quite slow in most parts of the District; home prices continued to fall, with the pace of decline quickening in some areas. Conditions in the commercial office market remained exceptionally weak, with demand for new and existing space reportedly held down by credit market constraints and uncertainty among potential tenants regarding future business conditions. Construction activity was very limited, except for specialty projects such as

hospitals and government facilities.

Financial Institutions

District banking contacts reported that loan demand remained very soft. Commercial and industrial loan volumes were at very low levels, as few businesses sought to expand production capacity or inventories. Credit quality deteriorated further, and the availability of credit remains quite constrained, with contacts reporting that some banks have withdrawn from entire lending lines. The sole bright spot was an increase in mortgage applications, especially for refinancing conforming home loans, which was spurred by the recent drops in interest rates on such loans.