Summary of Commentary on Current Economic Conditions by Federal Reserve District September 2000
SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICTS

SEPTEMBER 2000
TABLE OF CONTENTS

SUMMARY................................................................................................. i
First District – Boston ........................................................................... I-1
Second District – New York................................................................. II-1
Third District – Philadelphia............................................................... III-1
Fourth District – Cleveland.............................................................. IV-1
Fifth District – Richmond................................................................. V-1
Sixth District – Atlanta ................................................................... VI-1
Seventh District – Chicago ............................................................... VII-1
Eighth District – St. Louis ................................................................. VIII-1
Ninth District – Minneapolis ............................................................. IX-1
Tenth District – Kansas City............................................................... X-1
Eleventh District – Dallas................................................................. XI-1
Twelfth District – San Francisco .................................................... XII-1
Summary¹

Reports from the twelve Federal Reserve Districts indicated that economic activity expanded at a moderate pace in August and early September, even though further signs of slowing growth were noted in several Districts. Most Districts characterized economic conditions as strong and several said that economic growth continued to be solid. Richmond reported that growth had picked up from earlier in the summer. In contrast, reports from Atlanta, Chicago, St. Louis, and Minneapolis indicated that the overall pace of growth had softened in their Districts. Consumer spending was flat to modestly higher in most Districts in August compared with late spring and early summer. Several Districts noted that sales growth strengthened in early September. Manufacturing activity generally grew on pace, despite the recent shutdown of a few automobile assembly plants because of a lack of tires. Home sales and construction continued to soften, but several Districts reported that commercial real estate activity was robust. Overall loan demand remained strong, as firmer business demand more than offset continued weak mortgage activity. In agriculture, crop prices remained low and yield prospects dimmed in areas of the Southeast and Midwest experiencing prolonged drought conditions. Oil field and mining activity grew rapidly in several Districts.

Labor markets remained tight in most Districts, although signs of some easing were reported by Boston and Kansas City. Reports of wage increases were widespread and some firms indicated that higher labor costs were an increasing problem. Nevertheless, there were few indications that higher wages were being passed through to consumers as higher productivity and competitive pressures held firms' prices in check.

¹Prepared at the Federal Reserve Bank of Richmond and based on information collected before September 11, 2000. This document summarizes comments received from businesses and other contacts outside the Federal Reserve System and is not a commentary on the views of Federal Reserve officials.
However, several Districts indicated that the recent sharp increases in the costs of health care and energy might eventually be passed through to consumers. In contrast, reports from several Districts noted that prices of some metals, lumber, and other basic commodities had declined in recent weeks.

**Consumer Spending:** Several Districts reported sluggish retail sales growth during August, although expectations for sales through year-end were upbeat. Reports noted that apparel sales had been particularly weak in late summer. However, strong back-to-school sales in the New York, Richmond, Chicago, and Kansas City Districts, and improved sales of electronics in some areas, appeared to have boosted activity recently. Chicago said that overall retail sales grew at a rate above the national average, while Philadelphia and Atlanta indicated that sales fell short of retailers' expectations. Retailers' inventories were described as "in balance" and "at desired levels." Sales of electronics were generally higher, except in the San Francisco District, where they were flat. Despite a spate of manufacturers' incentives, automobile sales were slower in Atlanta, St. Louis, Minneapolis, Kansas City, and San Francisco. In Philadelphia, overall auto sales also eased, but luxury cars were selling well. In Cleveland and Richmond, auto sales picked up. Retail prices were steady in most Districts. Tourism and travel were softer in Richmond, partly due to memories of last year's storms, and in Montana where forest fires kept outdoors vacationers at bay. In contrast, tourism was stronger in the Atlanta and Minneapolis Districts.

**Services:** Reports indicated that business activity in services industries generally increased. Service providers in San Francisco "noted an acceleration in growth above an already rapid trend." Internet-related firms displayed strength in the Boston, New York, Richmond, and St. Louis Districts. In Dallas, demand facing transportation firms
remained robust. Labor shortages persisted, especially of employees with technology-related skills. The outlier was Boston, which reported that some layoffs in “dot-coms” had eased the labor shortages facing more established firms. District reports indicated that wage pressures have had little effect on final prices. Employers in Atlanta and Chicago expressed concern about higher health care benefits costs. Surging electricity prices were raising costs in the San Francisco District. New York reported, however, that there was some leveling off of previously skyrocketing electricity prices.

**Construction/Real Estate:** Most reports indicated that residential construction had softened further and that sales were flat or lower on a year-over-year basis. In contrast, Dallas reported strengthening residential conditions and Richmond and Kansas City reported stronger sales of higher-priced homes. In most Districts, inventories of houses have declined in recent weeks.

In the commercial real estate sector, reports from Boston and Philadelphia indicated that new construction had slowed, but that rents continued to rise in markets facing strong demand for space. New York reported that a severe shortage of office space in Manhattan continued to keep availability rates at historic lows. Boston contacts also reported low levels of office space availability in New England because of strong demand and relatively little new construction. In contrast, reports from Atlanta, Dallas, and San Francisco indicated that new construction had kept pace with rising demand.

**Manufacturing:** Manufacturing activity remained generally strong, although there were reports of moderation in some Districts. Over half of the Districts indicated that output at factories increased modestly to strongly, while Cleveland, Atlanta, St. Louis, Minneapolis, and Dallas noted signs of softening activity. Tire recalls led to shutdowns at automobile assembly plants near St. Louis and in Minnesota for two and
three weeks, respectively. District reports suggested that the light vehicle, aircraft, industrial machinery, and construction and building industries demonstrated substantial vigor, while the production of heavy trucks fell. Assessments of the furniture, appliances, and apparel industries were mixed. Reports indicated that increases in input costs were more widespread, particularly for paper, transportation, and energy-related goods. Boston and Minneapolis reported that input prices had increased for paper, while Atlanta said that rising energy prices had boosted transportation costs. The majority of the Districts noted that increased fuel and energy prices continued to raise production costs. Despite rising costs for inputs, competitive pressure prevented manufacturers in most Districts from raising prices.

Banking/Finance: Overall lending activity remained strong in most Districts, despite sluggish demand for residential mortgages in many areas. Chicago reported brisk business lending, while Philadelphia said that commercial lending had advanced at a fairly steady pace in recent months. Atlanta characterized commercial loan demand as "brisk," but noted that it was less vigorous than in previous quarters. Overall consumer lending was said to be strong in the Atlanta District and relatively robust in Chicago. Automobile loans were the fastest growing category of lending in Dallas and "quite strong" in Cleveland. Residential mortgage lending, on the other hand, slipped in Philadelphia, Cleveland, Atlanta, and St. Louis. New York reported that demand for all types of loans had fallen since their last report.

Several Districts reported that credit conditions had tightened. New York said that credit standards were generally tighter, particularly on commercial and industrial loans. Chicago reported that bank contacts indicated that credit standards were being tightened, but said that competition had constrained "how far they could go." Philadelphia noted
that some banks said they would consider implementing more restrictive credit standards in the fourth quarter if business conditions weakened. There were only a few reports of changes in delinquency rates; Cleveland said that some contacts had reported a rise in loan delinquencies because of higher debt burdens, while New York reported a decline in delinquency rates.

**Labor Markets:** Most Districts reported that labor markets remained tight. Several Districts continued to report that administrative workers with computer skills and information technology (IT) professionals were in short supply. New York cited a severe shortage of computer “techies” as well as unmet demand for office workers. However, Boston reported that layoffs at dot-coms and other start-ups were helping temporary employment firms meet the strong demand for employees from more established firms. In Atlanta, skilled labor such as nurses and IT professionals were said to be in short supply. In that District, businesses relied increasingly on overtime and investment in labor-saving technology to help counter labor shortages. Chicago noted that competition for qualified workers remained intense in most areas. Recruiting and retaining employees remained difficult for firms in the San Francisco District where rapid employee turnover and rising wage and benefit costs were tempering profits. Firms in that District were said to be considering additional investment in labor-saving technologies.

Most Districts said that wages edged up in August and early September. Boston said that firms had increased spending on benefits to retain workers, while New York reported that salaries for office workers were up more than 10 percent from a year ago. Wage pressures in Kansas City eased from earlier in the year although some firms were still offering sizable signing bonuses. Richmond indicated that wage pressures had intensified because of a continued strong demand for workers.
Agriculture and Natural Resources: Drought conditions in many areas of the Midwest and Southeast ravaged crops and impeded livestock production. Atlanta noted that production losses for some crops would run as high as 50 percent. Dallas reported that the Texas cotton crop had been declared a disaster—one million acres of the usual 6.3 million planted had been abandoned. Chicago and St. Louis said that dry weather had resulted in lower-than-expected corn yields. In contrast, Cleveland and Richmond reported that farmers expected higher-than-normal corn and soybean yields this year, and in Minneapolis, a potential bumper crop had farmers scrambling for storage space. Nearly half the Districts reported that low prices, caused in part by bumper yields, remained a concern for corn and soybean producers.

Dry weather in the Dallas and San Francisco Districts hindered livestock production. Dallas indicated that producers were providing supplemental feed and hauling water to livestock. Both Dallas and San Francisco reported that livestock farmers were paring herds. In Cleveland, however, dairy and livestock farmers reported excellent production. In Kansas City, strong consumer demand for meat continued to support livestock prices, while San Francisco noted that stable prices for beef cattle had benefited ranchers in that District.

Reports from Minneapolis, Kansas City, and Dallas indicated that oil-drilling activity continued to increase rapidly. Dallas noted that international drilling activity was also rising, but that it remained well below the peak levels of 1997 and 1998. Minneapolis reported that the iron ore and palladium industries continued to operate at full capacity, but that huge increases in electricity costs had halted production at a copper mine in Montana until at least November.
The First District economy remains strong, notwithstanding scattered signs that growth is slowing. Recent growth rates vary widely among both retailers and manufacturers. Most contacts are holding employment steady, although head counts at temp firms are up. A few respondents say their local labor markets are somewhat less tight than earlier in the year, but others see no loosening. Aside from hotel room rates and oil-related products, vendor and selling prices are generally little changed.

Retail

Retail contacts give mixed reports on sales growth at the end of the summer. Shoe stores, lumber and hardware stores, and a discount retailer say that same-store sales are flat or declining from year earlier. By contrast, specialty retailers, consumer electronics, and the hospitality industry report double-digit sales increases.

Most respondents are holding their employment levels steady. Unlike in June, none mention tight labor markets as a constraint on hiring. Wages are generally growing at an annual rate of 3 to 5 percent. Most contacts report steady prices. By exception, a discount retail chain is cutting prices in order to move inventory, while rates for Boston-area hotel rooms are rising at an annual rate of 7 percent. Profit margins are generally steady or rising; this is attributed in large part to constant or declining purchasing costs and, in the case of the hospitality industry, technology-based enhancements to productivity.

Contacted merchants generally believe the economy will continue to exhibit strong growth over the next 6 to 12 months; as a result, they are optimistic about their own sales prospects. The respondent in discount retailing expects weaker conditions. Lumber and hardware stores cite interest rate hikes as an ongoing brake on the economy.

Manufacturing and Related Services

Most First District manufacturing contacts indicate that recent business is up relative to a year earlier. However, their reports vary in tone, falling largely into two groups. Makers of semiconductors, pharmaceuticals, aircraft components, medical equipment, and furniture report that revenues are up 15
percent or more from a year ago. Almost all of these companies believe that demand will continue to be strong, and some cite labor or capital equipment constraints that already prevent them from keeping up with demand. Manufacturers of other products generally report that recent business is up less than 5 percent from a year ago. Most characterize these results as disappointing or below prior trends. They cite factors such as weak industrial demand or slower growth in retail sales or demand for office equipment. Respondents in a variety of industries--both fast- and slow-growing--indicate that the weak euro has eroded their export revenues.

Manufacturers indicate that they are paying more for paper, cotton fibers, petrochemicals, and energy. Other materials costs are mostly flat. Increases in selling prices remain selective and are largely confined to products in very high demand or for which input costs have risen.

Employment is largely flat, except at companies with rapidly expanding sales, but many employers complain that vacancies are hard to fill. Capital spending also is mostly flat except for companies adding capacity or involved in new Internet-related initiatives.

Average pay increases most commonly are in the 3 to 5 percent range, but higher at most expanding companies. For example, one firm in a “hot” industry plans to raise pay 10 percent in order to stem turnover and help recruitment among production workers. Another with a professional and technical orientation is giving 5 to 7 percent raises this year and expects to grant 6 to 10 percent increases next year. Another company with unfilled engineering needs plans to give key personnel raises in the teens plus bonuses. By contrast with these reports, a company trying to recruit for a new production facility does not plan extraordinary pay inducements but is instead exploring new ways to economize on labor.

**Software and Information Technology Services**

Most software and IT contacts report strong demand for their products or services. Some companies indicate that their revenues are now growing following a temporary decrease after the cessation of Y2K-related activity. By contrast, a firm that produces custom applications under contract reports that demand for its services has decreased sharply across a broad range of industries and geographic locations.
Contacts in the Boston area and New Hampshire report that labor markets remain extremely tight. However, a company in Rhode Island says that its labor market has loosened somewhat recently. And a respondent in central Connecticut indicates that although the labor market is tight, recruitment and retention are not major problems.

**Temporary Employment**

Contract employment firms in New England continue to grow. Overall revenues are up about 25 percent from year earlier, as a result of increases in both the number of projects and bill rates. Wages are also up, with one contact reporting a 20 percent hike from a year ago. In addition, contacts indicate they are increasing spending on benefits in order to retain workers. Demand for IT workers remains very strong. Other specialties such as office support, engineering, and medical are expanding as well.

Contacts also report increases in permanent placement services. Although temporary firms say the labor market is still very tight, they suggest that conditions have eased recently. Contacts indicate that layoffs at dot-coms and other start-ups are contributing to a lessening of labor market pressures, although demand from some larger and more established clients has picked up.

**Commercial Real Estate**

Contacts in commercial real estate report low levels of inventory in New England due to strong demand and lack of new construction. They anticipate no significant changes this fall.

The Greater Boston area is tight, with very low vacancy rates both downtown and in the suburbs. Although office vacancy rates increased slightly over the past quarter, rental rates continue to edge up, as demand for office space is still very high. Top office space rents for over $70/sq.ft. downtown and $40/sq.ft. in the suburbs.

Hartford continues to be the weakest market in New England, although its office vacancy rates have declined and rental rates increased slightly over the last two years. Hartford’s retail vacancy rates remain high and may rise further as construction is completed on new retail space.

Maine contacts report their lowest vacancy rates in a decade, for both office and retail space. With pent-up demand, both office and retail rental rates in Portland have increased sharply from a year ago.
Growth in the Second District’s economy has continued at a moderately brisk pace since the last report. Cost pressures have intensified, mainly for labor and energy, but prices of finished goods and services overall remain remarkably stable. New York City’s labor market continues to tighten, with salaries for office workers reported to be up more than 10 percent from a year ago. There are also signs of a pickup in hiring activity in the Buffalo area. Retailers report that sales were sluggish in August, with unusually cool and wet weather cited as a major factor; however, most note some improvement in early September. Due to steep markdowns on summer apparel, retail prices are flat to down slightly.

New York City’s office market remains extremely tight. Housing markets, which had eased a bit during the summer, have shown signs of picking up in early September. Declines in both new construction and home sales over the summer are partly attributed to supply constraints—a dwindling inventory of homes on the market, and a shortage of land and labor. Regional purchasing managers report continued strength in manufacturing in August, along with a marked pickup in cost pressures. Finally, bankers report weakening loan demand, tightening credit standards, and falling delinquencies.

**Consumer Spending**

Although there were wide variations among the major chains, retailers generally report that sales continued to run below plan in August, but improved somewhat in early September. Most contacts indicate particular weakness in summer apparel, which was largely attributed to unseasonably cool and wet weather. Also, two contacts note that consumers seemed to be less interested in this year’s summer fashions. Fall apparel, on the other hand, has reportedly been selling fairly well in early September. Sales of consumer durables—appliances, electronics, home goods, etc.—as well as home decor, cosmetics, and jewelry, were said to be fairly strong throughout the summer.
Despite the sluggish apparel sales, most retail contacts are satisfied with current inventory levels. Some contacts note that excess inventories of summer apparel had to be sold off at steep markdowns, but that they have mostly been cleared out. Selling prices have been steady to down slightly, reflecting these clearance discounts. Most contacts report little or no effect from rising shipping costs yet, but say that continued high fuel costs could put upward pressure on prices in the upcoming holiday season. One major chain reports that sharp increases in utility costs recently may push up selling prices at least slightly.

**Construction and Real Estate**

Commercial real estate markets remain tight as a drum, with Manhattan's severe shortage of office space showing little sign of easing in July. Office availability rates (the percentage of space that is either vacant or available for lease over the next year) edged up from 3.2 to 3.4 percent in Midtown and from 5.4 to 5.5 percent in Downtown—both are still near historic lows. Year-to-date, office rents have risen at an annualized rate of more than 40 percent in both areas.

Residential construction activity in the Second District has slowed from its brisk second-quarter pace, evidently reflecting both waning demand and a dwindling supply of land and labor. On a seasonally-adjusted basis, housing permits in New York and New Jersey fell for the second consecutive month in July. Single-family permits fell to their lowest level since late-1997; compared with a year earlier, they were down 17 percent in July and off 8 percent year-to-date. Multi-family permits, in contrast, were up 60 percent from a year earlier in July and up 29 percent year-to-date.

Anecdotally, builders in northern New Jersey report that land and labor supply constraints are mainly responsible for the recent decline in permits. Currently, the queue for new custom-built homes is so long that some builders are turning away customers, as they are reluctant to take orders for more than nine months out.
A major New York City realtor reports that prices of Manhattan co-ops and condos have risen only modestly in recent months but are still up 15-20 percent from a year ago. They also note that, although market conditions this past summer were a good deal less frenzied than last year, there has been a “tremendous pickup in activity” in the week after Labor Day. As for single-family homes, selling prices in the New York City area continue to run more than 10 percent ahead of a year ago, whereas both the number of sales and the inventory of homes on the market are noticeably lower than a year ago. Realtors in the Buffalo and Rochester areas indicate that, while both prices and unit sales are little changed from a year ago, they are struggling to find enough listings; if recent trends continue, they expect the dwindling inventory of homes to put upward pressure on prices.

Other Business Activity

In New York City, a major employment agency reports that there remains a severe shortage of workers, and that in terms of labor demand, the week after Labor Day was “incredible,” with the strongest hiring activity still coming from the financial services industry, followed by “dot-coms”. While the most severe shortages are for computer “techies”, excess demand is reported for office workers across the board; agency commissions are said to be up 15-20 percent from a year ago, mostly reflecting a 10-12 percent increase in salaries. Similarly, in the Buffalo area, a quarterly survey of local employers suggests a strong increase in hiring activity this autumn. Moreover, in downtown Buffalo, two major banks are in the process of adding substantially to their payrolls, and a leading cable TV company is planning a substantial expansion in the near future.

Regional purchasing managers’ surveys indicate further strength in the region’s manufacturing sector in August, along with a marked pickup in price pressures. Buffalo purchasers report that manufacturing activity expanded in August, but at a slower pace than in July; while there was a typical seasonal pickup in production activity, hiring activity retreated somewhat and new orders grew at a
slower pace than in July. Price pressures became increasingly widespread in August, after abating in June and July.

New York City area purchasers indicate that manufacturing sector activity accelerated in August, from July's already-strong pace, while purchasers in non-manufacturing industries were also increasingly upbeat about business conditions. Here too, input prices resumed their upward trend in August, after leveling off in June and July. While soaring energy prices were a major factor, widespread price increases also persisted for a variety of contracted services, led by construction, architectural, temporary help, and computer services.

After surging 40 percent above comparable 1999 levels in July, residential electricity costs in New York City and the Lower Hudson Valley retreated sharply in August and are seen leveling off in September. In these last two months, costs are estimated to be about 8 percent above last year's levels.

**Financial Developments**

According to the latest survey of local-area banks, demand for all types of loans fell since the last report, led by the residential mortgage segment. Refinancing activity continued to slow as well, with 41 percent of bankers reporting a dip in refinancing. Indicators on the supply-side were mixed. Credit standards generally tightened over this period, particularly on commercial and industrial loans, with 28 percent of lenders indicating more stringent credit standards.

Loan rates rose across all loan categories, with the most widespread increase on commercial and industrial loans. Similarly, average deposit rates rose, as noted by 47 percent of surveyed bankers. Delinquency rates fell for all loan categories.
Economic activity in the Third District has been moving up slowly. Manufacturing orders and shipments have been rising modestly. Retail sales rose for the back-to-school shopping period, although results were somewhat below retailers' expectations. Auto sales have edged down. Bank lending to businesses and consumers increased modestly, but residential mortgage lending declined. Real estate markets remain tight, and home prices and commercial rents have been rising. Although actual building activity remains fairly steady, construction contracting has eased.

The consensus in the Third District business community is that business activity will continue to move up. Manufacturers expect growth to increase slightly. Retailers look for somewhat better growth in sales this fall. Auto dealers expect the current downtrend in sales to level off at a pace somewhat below the rate set in 1999 and the first half of this year. Bankers expect continuing modest growth in lending to businesses and consumers, and they expect residential mortgage lending to remain steady. Although some growth in commercial and residential construction is anticipated in parts of the region, overall building activity is expected to be nearly level through the rest of the year.

MANUFACTURING

Manufacturers in the Third District were posting gains in orders and shipments, on balance, in early September. Increases were not widespread, however. Business was rising for producers of industrial machinery, metal products, transportation equipment, and paper products. For other major manufacturing sectors in the region, sales and production were steady. Order backlogs at area plants have slipped. Around a quarter of the manufacturers contacted for this report said costs continued to rise for the products they purchase. Although nearly all firms surveyed indicated they were not raising prices for their own products, some food processing companies and producers of primary metals were charging more for the goods they make.

Manufacturers forecast somewhat better business conditions. On balance, they expect slightly more rapid growth in orders in the months ahead compared with recent months. However, some producers of transportation equipment noted that demand was
slowing for trucks and autos, and they expect further declines. Overall, capital spending
plans for plants in the region include substantial increases.

RETAIL

General merchandise sales in the region got a boost during the back-to-school
shopping period in August and September, but several retailers indicated that year-to-year
gains were somewhat below their expectations. In particular, growth in sales of apparel
was weaker than planned. Conversely, sales of jewelry, televisions, and consumer
electronics rose strongly. Sales of personal computers rose solidly, especially in
Pennsylvania where the state sales tax was waived for these goods during the first week
of August. Despite slower than anticipated growth in sales, most of the store executives
contacted for this report indicated that their inventories were not significantly above
desired levels.

Looking ahead, merchants are cautiously optimistic. Sales of hard goods remain
strong, and retailers believe consumer confidence is still high. Store executives think that
if apparel to be introduced later in the fall proves popular, overall growth in retail sales
should accelerate. Several large national chains plan to open new stores in growing
suburban areas throughout the District, and this could provide the impetus for further
gains.

Auto dealers generally indicated that the pace of sales has been easing, although
some noted that luxury models have been selling well. Dealers believe sales will settle to
a steady rate for the balance of the year but remain below the relatively high pace set last
year and earlier this year.

FINANCE

Third District bankers surveyed in September generally reported that loan volume
outstanding at their institutions was growing slowly. Commercial lending has been
moving up at a fairly steady pace in the past few months, although more slowly than in
the first half of the year. Consumer lending has also been on the rise, but some banks
said growth has slowed since June. Commercial real estate lending increased slightly in
August and early September. Some banks also reported increases in residential mortgage
lending, but on balance, residential mortgage credit at area banks appeared to be declining.

Third District bankers continue to describe loan margins as tight. Some banks said they will consider implementing more restrictive credit standards in the fourth quarter, especially for commercial real estate loans, if the region's business conditions show any signs of weakening. In general, however, bankers expect the current pace of economic activity to persist through the end of the year, and they do not anticipate significant changes in credit conditions.

REAL ESTATE AND CONSTRUCTION

Commercial real estate markets in the region remain tight. According to recent surveys by brokers, office vacancy rates in the Philadelphia and Wilmington metropolitan areas have declined by about one percentage point since spring, to approximately 9 and 5 percent, respectively. Rental rates have risen around 10 percent since the beginning of the year, and brokers expect a similar increase in the next six months. In addition to higher rents, building owners have been requiring longer lease periods from new occupants. Demand for space has been strong among financial services firms, pharmaceutical companies, and computer services firms. Some firms have contracted to lease more space than they currently need in anticipation of rapid growth. Demand for industrial space, primarily distribution facilities, continues to grow. Ongoing expansion of interstate and local highways in the District has attracted national firms to locate manufacturing plants and warehouses along major transportation corridors. In addition, Pennsylvania has designated tax-free zones to encourage business development, and firms from outside the region have been locating new plants in these locations. Despite the strength of commercial real estate markets, new construction has been slower recently than in the first half of the year, although a pickup in office and industrial construction has been observed in some areas where vacancy rates have fallen to very low levels.

Residential real estate activity has eased, according to brokers and builders. Existing home sales have recently been running below the year-ago rate in most parts of the District, and new home sales have slipped from the pace set in the first quarter of this year. However, some brokers and builders reported increased sales in areas where job
growth has been strong and in newly developing suburban areas. Despite the falloff in sales, some brokers indicated that price appreciation for existing homes has accelerated. Builders generally noted continuing steady price increases for new homes. Both builders and brokers anticipate a level pace of sales through the end of the year unless mortgage interest rates increase.
General Business Conditions and Labor Markets

Growth in economic activity in the Fourth District has experienced little change since our last report, remaining moderate. Prices are stable for most goods except for the rising price of fuel. Wages continue to grow at a moderate pace. The fall in the rate of residential construction appears to have moderated.

The market for temporary workers is described as tight, particularly for administrative secretaries. The tightness is expected to be exacerbated as college students return to school. All contacts indicated that demand for temporary workers is expected to increase over the next two months. Retailers and trucking firms reported that filling positions has been very difficult.

Union contacts reported that recently negotiated contracts granted average wage increases of about 4 percent. The public sector experienced wage increases that were somewhat above the private sector, reversing recent patterns when this sector has tended to lag. The union contacts also reported success in negotiating stronger employment security provisions.

Construction

In contrast to the declining activity of the spring, District residential construction reportedly held to a steady pace during the past six weeks, albeit at low levels. Prices for new homes have fallen, while total costs have been flat, leading to a decrease in profit margins for homebuilders. The distribution of builders' costs has changed: fuel costs have risen, while lumber and drywall prices have fallen.
Conditions in the commercial building sector appear to have held mostly steady since the last report, although a small decrease in industrial building and warehouse construction was noted. No significant changes in labor and materials costs have been seen in this sector.

**Industrial Activity**

The demand for steel has softened a bit, causing a slight decline in its price. The lower demand is expected to continue until inventory in the steel service centers declines, which could take several months. Rising energy prices have significantly increased the costs of producing steel.

Heavy truck manufacturers expect cuts in production as large as 20 percent year-over-year due to the low sales they have seen over the past six months. High fuel prices and low used truck prices are reportedly responsible for low sales of new trucks. These companies also reported a small decline in the demand for trucking services. Orders are flat for heavy construction equipment.

**Consumer Spending**

District retailers reported steady sales throughout the summer, although receipts did not match last year's season. Recent markdowns in summer apparel (in anticipation of the change to winter inventory) have done as well as expected. Retailers anticipate no change in spending in the next six weeks.

Auto sales were quite strong in August when compared to previous months, particularly among those dealers whose manufacturers offered price reductions (often through rebates.) Despite the strong August sales, year-to-date performance is slightly below last year's strong pace. There is little evidence that total unit sales were affected
by the increase in petroleum prices, although more consumers are choosing smaller cars with better gas mileage. The market for used cars is also strong, and some contacts reported that this was caused by the high price of leased vehicles.

Agriculture

Most District farmers expect high yields in corn and soybeans this year, with the exception of the northernmost counties, where yields are depressed by late planting, disease, and cloudy August weather. Dairy and livestock farmers also reported excellent production, with some areas predicting their best year on record. In spite of this, low commodity prices are ensuring that profit rates remain low in most farming sectors, and farmers in the north of the District are expected to show a net loss for the year.

Banking and Finance

Commercial lending has remained steady over the last six weeks, although the number of new loans is lower than it was one year ago. Mortgage lending is slowing and many contacts reported a year-over-year decline. Bankers attributed the decline to higher interest rates. However, auto loans, are still quite strong, fueled by the increase in summer auto sales. Most banks reported, however, that this acceleration has disappeared in recent weeks, and they do not expect auto loan growth to continue into the fall. Although the rate of loan delinquencies is generally reported to be unchanged, some contacts reported a rise due to increased debt burdens. Many of our contacts reported that people who formerly would have made large deposits are now investing directly in mutual funds and stocks, creating increased competition for deposits.
FIFTH DISTRICT – RICHMOND

Overview: The Fifth District economy expanded at a quicker pace in August and early September than in previous months, as activity at retail and services firms rebounded from a mid-summer lull. Retail sales growth was brisk in recent weeks, driven by back-to-school and big-ticket purchases. Services firms recorded substantially higher revenues in August and contacts were notably more upbeat about future sales growth. Manufacturing activity remained generally strong, despite some easing in the growth of new orders. Activity in real estate and banking was bolstered by lower mortgage rates in recent weeks. In labor markets, employment growth downshifted in August, but wage growth was largely unabated. Price increases were more modest in manufacturing, but little changed in the services sectors.

Retail: Stores were busier and sales grew more rapidly in August and early September than in previous months, with some respondents reporting an improvement in big-ticket sales in the last two weeks. Retailers said that back-to-school sales were better than last year, and that sales of most other items were firm. Both automobile and appliance dealers noted that early September revenues were higher in part because of attractive manufacturers’ incentives. Retail employment fell in August as summer employees left, while average wage growth picked up further. An apparel retailer in Charleston, W.V., said he had raised base wages in order to attract qualified part-time employees and, as a result, also had to raise wages for full-time employees. A manager at a large department store chain said that he was increasingly “struggling hard to get entry-level people” and that his store was considering raising wages to attract those employees. However, retailers indicated that higher wages have not generally affected the prices they charge.

Services: Revenues at services firms rose moderately in August, in part because of increased Internet-related revenues. A car rental agency reported very strong summer business and noted a significant increase in rentals booked through its Internet site. In addition, a website design company in West Virginia reported higher demand for its services, and also noted more on-line contacts. Employment slipped, however, at a number of companies that relied heavily on summer workers as those jobs ended. Wages remained stable with the exception of high-tech positions, which continued to command wage increases. Looking forward, many contacts expected demand for their services to strengthen in coming months.
Manufacturing: Activity at District factories remained generally strong since our last report. Growth in manufacturers' shipments picked up in August, but growth in new orders sagged. Contacts in the food, tobacco, and industrial machinery industries reported particularly strong business activity. In contrast, some contacts at furniture, chemicals, and rubber products manufacturing facilities noted that their shipments fell slightly in recent weeks. One furniture manufacturer told us that furniture sales had declined markedly since early May, when his company was running factories on overtime. Now, he said, they have laid off employees and are operating several plants only four days per week. In labor markets, manufacturing wages grew more slowly in August, while employment was little changed. Despite higher wages, prices for manufactured goods rose only slightly.

Finance: Loan officers reported that generally strong business conditions and lower interest rates contributed to somewhat higher demand for loans in recent weeks. Commercial bankers said that business loan demand was being driven mainly by businesses' expansions. A commercial lender in Greenville, S.C., noted that some companies that had put expansion plans on hold two months ago were now going ahead. Competition for commercial loans remained intense; a Norfolk, Va., lender said that some of his competitors were offering "crazy" interest rates and terms to attract business. Residential mortgage lenders reported a general increase in lending activity as mortgage rates eased in August. A Charleston, S.C., lender reported a recent spurt in demand for mortgages; in his words, business was, "as good as [it] can be."

Real Estate: Residential realtors reported a pick-up in real estate activity in August. A realtor in Columbia, S.C., described sales activity as strong and added, "Now that the fear of rising [interest] rates is gone, people are back in the market." Realtors in Charleston, S.C., and in the District of Columbia noted that sales of upper-end homes remained brisk. In contrast, corporate layoffs in Greensboro, N.C., resulted in weaker sales of upper-end homes in that area. Wages in the construction sector moved moderately higher, while building materials costs were level for most items, and lower for lumber and sheetrock.

Commercial realtors in the District reported little change in real estate activity in recent weeks. While the market for Class A office space remained tight, some realtors indicated that speculative office development had slowed. But some exceptions were apparent. A contact in Charlotte, N.C., noted an increase in office construction in suburban areas. Lower vacancy rates for warehouse space were said to be placing upward pressure on
rents in Maryland, and land for construction of additional warehouses was reported to be in short supply. Rents for office space were generally little changed, but District of Columbia realtors noted that some landlords had raised security deposits for “dot-com” companies in anticipation of a shakeout in that sector.

**Tourism:** Heavier-than-normal rainfall throughout the District caused tourist activity to soften in August. According to contacts in Virginia Beach, bookings for the Labor Day weekend were initially somewhat lower than last year and the inclement weather exacerbated the decline. A hotelier on the Outer Banks of North Carolina said that tourists appeared hesitant about booking late-summer vacations in the area, fearing a recurrence of the severe storms that struck there a year ago. A resort manager in Virginia noted that occupancy rates were lower, in part because companies were holding business conventions later this year. Despite the August softening, expectations for tourist activity during the next six months remained good.

**Temporary Employment:** Demand for temporary workers remained generally strong in recent weeks. Administrative workers with computer skills and light industrial workers continued to be in high demand. A Maryland contact said that he had seen an across-the-board need for workers—from entry-level administrative to high-end technical. While wages in many areas were reported to be little changed, the manager of an employment agency in Hagerstown, Md., and an agency contact in Charleston, S.C., said that wages were moving up because of the widespread higher demand for workers in those areas.

**Agriculture:** Above-normal rainfall in late August and early September brought relief to drought-stricken areas in the District but increased concerns about disease and crop quality in other parts of the region. While improved soil moisture levels helped drought-stricken areas of South Carolina, rainy weather and wet fields delayed corn and hay harvests and contributed to fungal disease in peanuts in other areas. Despite the rain, farmers made good progress in harvesting tobacco, peaches and apples. District agricultural analysts expect higher yields this year for corn in Maryland and North Carolina and soybeans in Maryland and South Carolina.
VI-1

SIXTH DISTRICT – ATLANTA

Summary: Reports from across the District suggest that the pace of economic growth in the Southeast has continued to ease. Descriptions of retail and auto sales growth were varied, but generally on the weaker side. The single-family housing market remained flat to down slightly compared with a year ago, which is in contrast to the continued strength of the commercial market. Contacts noted some planned expansion in manufacturing activity, and accounts by representatives of the tourism and hospitality sector were positive. Bankers reported strong consumer and commercial loan demand with no major signs of deterioration in loan quality. The demand for skilled labor continued to outstrip supply, while some easing in the pressure for lower-skilled workers was indicated. Direct and secondary effects of higher energy and health care costs remained the most cited pressure on prices. The agricultural sector continued to reel from the ongoing drought in many parts of the District.

Consumer Spending: Sales growth reportedly varied considerably among District retailers during the early part of third quarter. Overall, same-store sales growth was moderate, but most stores said that late summer sales results had fallen below expectations. Merchants in several areas reported that an earlier than usual start to the school year may have damped sales. Inventories were mostly described as balanced, although some instances of deeper than normal discounting were reported. Generally, District retailers remain confident that third-quarter sales growth will come close to year-ago results.

Construction: The single-family housing market continued to perform below last year’s high levels in most areas of the District. Over half of the builders contacted said that home construction was equal to or slightly below last year’s level during July and August and that sales of new homes weakened during August. However, new home inventories were mostly described
as balanced. Reports from real estate agents suggest that existing home sales during July and August were mixed and that inventory levels varied by location and price. Realtors noted that there was little evidence of overbuilding. Looking forward, contacts expected few changes in the single-family market through the remainder of the year.

The commercial real estate market continued to perform at strong levels and growth remained balanced overall. Vacancy rates were generally low and absorption continued at a healthy pace across most of the region. Contacts noted that developers and lenders have become increasingly cautious about speculative construction.

**Manufacturing:** Three vehicle assembly firms recently announced plans to invest a total of over $2 billion and hire about 5,500 workers over the next few years at plants in Alabama and Tennessee. On a less positive note, in Alabama, a large steel mill is expected to shut down in a few weeks with the loss of about 1,800 jobs. Improvements in the energy sector have increased the demand for products of oil field service companies. However, a plastics manufacturer reported that increases in the cost of petroleum-based raw materials has caused him to cut back production and layoff staff. Reduced building activity, together with weak exports and increased production, has adversely impacted District lumber producers.

**Tourism and Business Travel:** Reports from the tourism and hospitality sector were generally upbeat. Hotel and resort contacts in south Florida say that the summer months generated better revenues and occupancies than in 1999 and that bookings for the fall are slightly ahead of last year's pace with little discounting. There is continued concern that increased energy prices may eventually discourage travel and tourism to south Florida during the peak winter months. Some reports from northern Florida suggested that earlier school start dates in
parts of the District slowed end-of-summer business. Along the Mississippi Gulf Coast, casino revenue growth has slowed markedly from last year.

**Financial:** Contacts indicated that consumer loan demand continued to be strong, and commercial loan demand was brisk but less vigorous than in previous quarters. Venture capital financing remained active. Overall loan quality was said to be good with no major signs of deterioration. Declines in net interest margins and low deposit growth were noted as increasing concerns for some District banks. Residential mortgage demand was described as soft.

**Wages and Prices:** Labor markets remained tight, but there has been moderate easing in some sectors, such as the apparel and the paper and lumber sectors because of weaker product markets. A construction industry spokesman said that more subcontractors than before were looking for work. Another contact noted that skilled labor such as nurses and IT professionals remained in short supply. Several reports suggested that businesses have reacted to continuing labor shortages by increasing the amount of overtime and by investing in productivity enhancing technology.

Energy and health care continued to be the primary sources of pressure on input costs, and increases in stainless steel prices, the price of plastic, and transportation charges, were described as indirect results of rising energy prices. A large District company was reportedly expecting a 14 percent increase in health insurance premiums in 2001.

**Agriculture:** The drought continued to take a large toll in many parts of the District through the summer months, with the loss in production estimated to be over 50 percent for some crops. Low product prices, together with higher energy costs and increased use of irrigation, has further impacted farm profitability. Large parts of the District, including all of Georgia and parts of Florida, remained eligible for federal agricultural disaster assistance.
SEVENTH DISTRICT—CHICAGO

Summary. The Seventh District’s economic expansion continued to slow in recent weeks. Consumer spending was generally soft in August, but picked up in early September. Nonresidential construction activity remained robust while sales of new and existing homes were slightly softer than a year ago. Manufacturing activity remained strong, but reports increasingly suggested that growth slowed further. Bankers noted that overall loan demand remained strong, and some reported a slight pickup in mortgage refinancing activity. Contacts noted no respite from worker shortages in recent weeks, despite slightly higher unemployment rates. District farmland values rose in the second quarter but at half the rate of increase in the previous two quarters. Crop conditions remained good in most areas but had deteriorated modestly in recent weeks as hot, dry weather returned to the corn belt. There were no new reports of broad-based price increases at the retail level and wage pressures remained generally subdued. Contacts, however, more frequently expressed concern over substantial increases in health benefit costs.

Consumer spending. Retail sales softened somewhat as consumers appeared to “take their foot off the pedal” in recent weeks, according to contacts. Merchant reports generally suggested that sales results met their conservative plans, with same store sales increases in the low to mid-single digits. Apparel sales were again soft in August, but were reportedly picking up in early September along with back-to-school sales. Sales of home-related items such as appliances and electronics remained strong. Many contacts suggested that overall retail sales in the Midwest, which had been relatively weaker, were now outperforming the national average. Store inventories were generally in good shape and there were no reports of extraordinary promotional activity. A large auto dealer group reported that vehicle sales improved in August and service orders, which had been very soft, also picked up. A national retail chain noted a significant pickup in tire sales and service at its automotive centers, which this contact attributed to more consumer concern in the wake of a major tire recall. There were no new reports of intensifying price pressures at the retail level.

Construction/real estate. Overall construction activity remained strong, with contacts generally indicating that the nonresidential segment was firmer than the residential. Office construction in the Chicago area remained very active, and development of light industrial space was reported to be picking up in central Indiana. One contact suggested that official statistics
were not reflecting the true strength of nonresidential activity. Infrastructure spending remained strong throughout much of the District, buoyed by highway projects. Reports on new housing activity were mixed. Housing starts remained at high levels in recent months, practically unchanged from the same period last year. However, Midwest builders suggested that new home sales were slower than in the same period last year. One contact pointed to some inventory buildup in new single-family homes in central Indiana. Realtors also noted that existing home sales were off modestly from last year, but the market remained generally strong. There were reports that the inventory shortage of existing homes had eased somewhat in recent months.

**Manufacturing.** Manufacturing activity remained generally strong, but contacts suggested that growth continued to slow in August and early September. Some District purchasing managers’ indexes even suggested a slight contraction in August. Nationwide, light vehicle sales picked up in August, but were somewhat softer than earlier in the year. Through August, however, the auto industry remained on pace to shatter last year’s sales record. Inventories were down somewhat as dealers cleared out 2000 models, but industry contacts suggested that new orders were somewhat soft. Steel production slowed as orders from the auto industry softened and imports increased. The increase in imports was also cited for halting, and even reversing somewhat, recent increases in steel prices. Contacts reported a substantial slowdown in heavy equipment manufacturing, especially for heavy trucks. Appliance makers noted that shipments fell off significantly in July and August after a large retailer decided to stop selling appliances.

**Banking/finance.** Overall lending activity remained strong in August and early September. Consumer lending remained relatively robust, with little change in momentum recently. A few lenders, citing a decrease in fixed-rate mortgage interest rates since May, reported modest increases in home refinance lending. Some homeowners who took out adjustable rate mortgages last year were switching into fixed-rate products, according to one contact. There was no change reported in consumer loan quality, which remained high. Business lending continued to be brisk in most areas, with little change in the rate of increase reported. Most contacts suggested that standards were being tightened, but competition was placing constraints on how far they could go. Lenders asked commercial real estate borrowers for more equity stake in some areas, continuing a trend toward tighter lending standards in this
segment. One large bank noted that these tighter standards, as well as higher margins, had not slowed the expansion in commercial real estate lending.

**Labor markets.** Shortages of workers persisted in the District in recent weeks and contacts noted little change in tight labor market conditions. Official statistics showed that the unemployment rate in District states had increased modestly since the beginning of the year, but most contacts did not seem to notice any change. Reports indicated that unfilled positions and higher turnover rates had become the norm. Students left the workforce and headed back to school, ending the temporary respite from the tight labor markets for some employers. Competition for qualified workers remained intense in most areas. One contact noted that an argument broke out at a local Chamber of Commerce meeting as members accused each other of "raiding" their employees. Wage pressures continued, but did not appear to intensify recently. Small businesses were particularly concerned about rising health care costs. While strong productivity gains largely offset the cost pressures of higher wages, one business leader expressed concern that they would not be enough to offset increases in health benefit costs.

**Agriculture.** District farmland value gains slowed to 1 percent, on average, in the April 1 to July 1 period, half the gain of the previous two quarters, according to a survey of agricultural bankers. Bankers reported some weakening in agricultural loan demand and an improvement in loan repayment rates, relative to a year ago. Interest rates on farm operating loans were reported to be at their highest level, on average, since the early 1980s. Crop conditions deteriorated from the earlier "very favorable" rating as dry weather returned during August and early September. The warmest temperatures of the season for much of the corn belt compounded the negative impact of topsoil moisture depletion. These conditions hastened the maturation process; the corn harvest in the southern reaches of the District began in early September with yields, by some accounts, lower than expected. Press reports of insect infestations and weather-related damage to soybeans and, to a lesser degree, corn were confirmed by farmer contacts and the state reporting agencies, with the probable impact on yields not yet clear.
Summary

Some moderation in the pace of District economic activity has been noticed since the last report. Retail sales are up this year over last, despite some sluggish back-to-school sales. Overall, retail sales generally met expectations. Business contacts report that sales of apparel have slowed somewhat recently. Home sales and construction continue their downward trends. Banks are still experiencing lethargic deposit growth, although loan growth remains relatively steady. Demand for real estate loans, however, has continued to decline along with the demand for new homes. Dry, hot weather in the southern parts of the District has dramatically affected the quality of the soybean and cotton crops.

Consumer Spending

Retailers report that sales during July and August were up about 4 percent on average from a year earlier. Grocery and department stores show the strongest growth, while many stores report slow back-to-school sales. In most cases, sales growth has met expectations; however, at some discount stores and gift shops, sales growth has fallen below expectations. Across the board, contacts note that sales of men's and women's apparel have waned in the last two months. Sales of home furnishings, gardening supplies and electronics, such as big-screen television sets and refrigerators, have been robust. Nearly all retailers' inventories are at desired levels. Most contacts are very optimistic about the holiday season, expecting strong sales increases over last year.

Car dealers report that sales in July and August were down slightly from a year earlier. About a third of contacts cite a lack of inventory of some models and higher interest rates for the sluggish sales. About another third have excess inventories that they have tried to pare by increasing the dollar amounts and availability of rebates. Sales prices, however, remain
unchanged from last year. Even though car dealers report somewhat erratic sales so far this year, most expect to finish the year with double-digit sales increases over last year.

Manufacturing and Other Business Activity

Contacts report that business activity has moderated slightly in the past two months, with demand for most goods declining a bit. Demand for some durable goods, such as furniture and appliances, is reportedly stable, however.

Internet companies continue to locate in the District. In Louisville, for example, a web-based insurer will create almost 200 jobs, and an Internet service center is hiring 290 for its expansion. In northern Kentucky, a large clothing company will open a distribution center and hire about 850 workers.

Several closings are also occurring in the District. In Memphis, FedEx plans to cut 200 technology jobs, and an electronics firm will send more than 300 manufacturing jobs abroad in the next three months. The recent tire recall forced Ford to close an assembly plant near St. Louis for two weeks to free up needed tires.

With qualified workers difficult to find, labor shortages continue to be a problem for nearly all industries, although contacts note that wage pressures have been negligible. With gasoline prices moderating, trucking companies are starting to feel some relief from the profit cuts they had previously been forced to accept.

Real Estate and Construction

Home sales continue to slow in most District areas. Year-to-date sales of homes, especially in the $200,000 to $400,000 price range, are below their year-earlier levels. Consequently, most real estate agents note that home inventories are on the rise. Still, agents believe that declining demand will turn around, and are optimistic that sales will level out over the rest of the year.
Mirroring sales, residential construction has been declining throughout the District over the past two months when compared with a year earlier. Monthly and year-to-date residential building permits are down from their month- and year-earlier levels. Commercial construction has recently been mixed. In some areas, such as western Tennessee, builders report a decline in the number of new projects, while in other regions, such as the Louisville area, construction remains brisk, with several large projects under way. St. Louis has felt the effect of the eight-week-long concrete drivers’ strike, which held up numerous construction projects.

Banking and Finance

Bankers continue to see a decline in the use of deposit accounts by customers. Reports of declines in total deposits of up to 10 percent year-to-date, when compared with a year earlier, are not uncommon. At the same time, loan growth remains relatively stable, with commercial and industrial loans still carrying the load. Some bankers note, though, that average loan size in this category is shrinking. Real estate loans continue to be hit hard, as demand for new homes falls. One contact indicates, for example, that residential real estate loans at a sample of banks in one region are off by almost one half in volume and 40 percent in value this year when compared with last year. Banks are generally less willing to lend for speculative home building this year than last.

Agriculture and Natural Resources

Record hot, dry weather in August has continued to adversely affect crop and pasture conditions in the southern parts of the District, where soybeans and cotton are reportedly in poor-to-fair condition. Irrigated cotton fields, however, are faring somewhat better. The weather has also hastened the maturation of the cotton crop and the pace of the corn harvest, which, according to early USDA estimates, has resulted in moderate yield declines in Arkansas and Mississippi. The soybean crop in the northern parts of the District is in good-to-excellent condition, while the rice crop is reportedly in good shape overall.
NINTH DISTRICT--MINNEAPOLIS
Economic growth in the Ninth District shows signs of slowing. The construction, tourism and manufacturing industries as well as consumer spending have softened. Meanwhile, energy and mining activity continues at a robust pace. In agriculture, most district farmers expect a bin-busting harvest, but crop prices remain low. A drought and fires have hurt most Montana farmers and ranchers. Labor markets are still tight as businesses struggle to attract and retain workers. Some price increases are noted, primarily in housing, natural gas, electricity and paper.

Construction and Real Estate
Commercial construction continues to grow, but at a slightly slower rate. Building contracts awarded in the Dakotas and Minnesota increased 2 percent for the three-month period ending in July compared with last year. A commercial real estate firm predicts that downtown St. Paul will reach 10 percent to 12 percent vacancy rates during the first quarter of 2001, and some rental rates have dropped due to oversupply. In contrast, building activity in Eau Claire, Wis., is at a record pace.

Homebuilding remains soft. Housing units authorized are down 6 percent in the district for the three-month period ending in July compared with a year earlier. In Minneapolis-St. Paul the number of residential sales decreased 7 percent for July compared with last year; however, the median price for a home in Minneapolis-St. Paul in July was up 12 percent over a year earlier.

Consumer Spending and Tourism
The pace of consumer spending continues to show signs of slowing. A major Minneapolis-based retailer noted that July same-store sales increased 2.5 percent compared with a year ago. Retailers in Minnesota are not enthusiastic about the year so far, according to a state chamber of commerce representative. Auto sales are down about 9 percent in the Duluth, Minn., area and slower overall in North Dakota, according to representatives of automobile associations. In contrast, a Minneapolis area mall reports July sales up 10 percent over last year.

Summer tourism decreased in several parts of the district, except for Minnesota and Wisconsin. Traffic crossings at the International Bridge at Sault Ste. Marie, Mich., were down 7 percent in August compared with last year, indicating a drop in tourism activity for the Upper Peninsula. A bank director reports sales down 1 percent to 10 percent compared with a year ago at various district tourism businesses. Montana forest
fires have hurt outfitters and guest ranches; however, the fire fighting effort has added $1 million per day to supporting businesses in the affected areas, according to a bank director. A chamber of commerce representative in Wisconsin reports full bookings at resorts and brisk restaurant business this summer. According to a survey of tourism businesses in Minnesota, the number of visitors was up over a year earlier.

**Manufacturing**

Manufacturing activity in the district has slowed. A southern Minnesota clothing company is planning to shut down a factory and shift production to other countries, a paper producer is closing distribution centers in South Dakota and northern Minnesota, and a promotional goods manufacturer is closing operations at a newly built Minnesota manufacturing facility. In addition, recalls are also affecting some district manufacturers; a major truck assembly plant in Minnesota shut down for three weeks due to a tire recall, and an all-terrain vehicle manufacturer had to recall an estimated 8 percent of this year’s production. An August purchasing manager survey by Creighton University indicates a significant manufacturing slowdown in Minnesota, but strong growth in the Dakotas. A Dakota construction products company reports strong demand, a machine parts manufacturer in the Upper Peninsula of Michigan plans to double its manufacturing capacity, and a western Wisconsin corrugated material product firm reports strong sales.

**Mining and Energy**

The iron ore, palladium and petroleum industries continue to operate at near capacity. June iron ore consumption was 14 percent above year-ago levels, while June inventory levels were down 15 percent from a year earlier. District iron ore shipments in July were up 11 percent from a year earlier. In addition, palladium production is at full capacity. However, due to a huge increase in electricity costs, a Montana copper mine stopped production until at least November, according to a bank director. Meanwhile, district oil exploration and production continue at a strong pace in response to high petroleum prices.

**Agriculture**

“Improved livestock prices and hopes of above-average yields will offset the poor grain prices,” reports a Minnesota agricultural lender. Farmers’ financial condition continues to improve, based on preliminary results of the Ninth District’s third quarter (August 2000) survey of agricultural credit conditions. Loan repayments have improved, as 72 percent of respondents report average or above-average levels of loan repayments compared with 41 percent a year ago. In addition, farm income improved as 46 percent of respondents
reported average or above-average farm income compared with 14 percent a year ago. However, fires, drought and continued low crop prices have many lenders worried that ranchers and farmers will incur financial losses this year.

A potential bumper crop has many Ninth District farmers scrambling for storage space. The U.S. Department of Agriculture reports corn and soybean progress ahead of the five-year average for many district states. Meanwhile, with many farmers still storing their 1999 crop, grain storage manufacturing companies report strong demand for storage silos.

**Employment, Wages and Prices**

The district labor market remains tight. For example, the number of applications submitted for law enforcement jobs in Fargo, N.D., has dropped from an average of 300 applicants a few years ago to 30 today. Nevertheless, employers are planning to hire more workers. In a recent survey conducted by a temporary staffing company, 43 percent of Minneapolis-St. Paul businesses expect to hire more employees during fourth quarter 2000 compared with 40 percent a year earlier. An electronic commerce company in Grand Forks, N.D., is currently in the process of hiring 150 new workers. However, in spite of signs that employers are seeking more workers, employment growth in district states has slowed. Employment increased 1.3 percent in July 2000 compared with a year earlier, down from an increase of 2.4 percent in July 1999 from July 1998.

District manufacturing wages for July are up 3.2 percent compared with a year earlier. Wages for field and livestock workers in the district climbed over 6 percent in July compared with last year. A Minnesota building product manufacturing company is increasing wages 4 percent, but predicts that improved productivity will offset the increase in labor costs. A recent 78-day strike at a soft drink bottling company in the Minneapolis area ended with a settlement that included about a 2.7 percent increase in wages.

Increases were noted in energy and input prices. Winter heating costs are expected to increase from last year due to higher oil and natural gas prices. Diesel fuel prices are up almost 30 percent compared with a year earlier. Montana electricity prices for large firms have reached record levels since May. Paper prices have increased for 15 consecutive months. A recent informal survey of manufacturers in the Dakotas, Minnesota and Wisconsin shows that about 40 percent of respondents report higher input prices.
Overview. The Tenth District economy remained solid overall in August. Retail sales continued to improve, manufacturing activity was stable, and the energy sector expanded further. One area of weakness was residential real estate, which continued to cool. In the farm economy, large corn and soybean harvests are expected to keep crop prices low. Tightness in district labor markets eased slightly, and wage pressures were similar to the recent past. While price pressures intensified for some manufacturing and construction materials, retail prices generally held steady.

Retail Sales. Most retailers reported steady or increasing activity from July to August. For the second survey in a row, sales were also up from a year ago at most stores. Sales of shoes and apparel at discount retailers were particularly strong, as consumers prepared for the start of the school year. On the other hand, apparel sales were weak at higher-end stores in the district. Store inventories have edged up since the previous survey, and managers' expectations of future retail activity remain very strong. Motor vehicle sales declined slightly in August. With the end of the 2000 model year, dealers were working to reduce inventories to make room for the new models. Expectations for vehicle sales in coming months remain rather subdued, however, particularly in some rural areas.

Manufacturing. District factory activity was stable in August after softening in July, and most firms reported medium to high levels of capacity utilization. However, weakness in the trucking industry due to higher fuel costs has adversely affected some producers of transportation equipment in the district. Material availability problems surfaced in August for a few items, including glass and plastic, but remained manageable. Meanwhile,
lead times were largely unchanged. Many plants continued to report a reduction in inventories, with plans for further trimming of stock levels in coming months.

**Real Estate and Construction.** Residential construction activity continued to slow in August, and nearly all homebuilders contacted for the survey reported that housing starts were down from a year ago. An exception to the slowing trend has been luxury home construction, which remains quite strong. Building materials were reported to be generally available in August. After several months of decline, most builders expect overall construction activity to level off for the remainder of the year. Home sales eased throughout much of the district but remained close to year-ago levels in some cities. The slower sales this year have increased inventories of available housing from the low levels reported in earlier surveys. Mortgage demand remained rather weak in August, with virtually no refinancing activity taking place. Lenders expect this sluggishness to continue in coming months.

**Banking.** Bankers reported that loans increased and deposits held steady over the past month, boosting loan-deposit ratios. Demand rose for commercial and industrial loans, commercial real estate loans, and home equity loans. Loan demand in other major categories was unchanged. On the deposit side, demand deposits, NOW accounts, money market deposit accounts, and small time deposits all declined. Some rural bankers attributed the deposit declines to increased competition from mutual funds, the availability of funds from alternative sources such as the Federal Home Loan Banks, and long-term demographic shifts. Almost all respondent banks left their prime lending rates and consumer lending rates unchanged during the past month, and almost all expect to hold rates steady in the near term. Lending standards were generally unchanged.
Energy. Energy activity in the district continued to improve in August and early September, as oil and natural gas prices remained high. The count of active oil and gas rigs in the district has increased for six consecutive months and is now the highest since 1993. After easing slightly in July, natural gas prices have resumed their climb upward, pushed by tight supplies. Moreover, the price of West Texas intermediate crude oil rose further in early September.

Agriculture. Despite hot, dry weather, big corn and soybean crops are expected this fall, promising to keep grain prices low. The dry weather has hurt district pasture conditions, limiting the supply of forage. Strong consumer meat demand continues to support livestock prices. The high price of young feeder cattle, however, has trimmed profits for district feedlots and boosted profits for ranchers. District bankers report that farm loan portfolios remain healthy due to strong livestock profits and big government subsidies for grain producers.

Wages and Prices. Labor markets in the Tenth District experienced some relief in August, particularly for skilled manufacturing and construction workers. However, entry-level and retail workers remained difficult to find in most parts of the district. As in the previous survey, most business contacts reported that wage pressures have eased from earlier in the year. Some firms, however, were still offering sizable signing bonuses. Price pressures intensified for many manufacturing materials in August, due largely to increases in oil prices. Builders reported that prices for some construction materials also rose for the first time since the spring. Retail prices edged down at several luxury retailers, but are expected to rise again in the fall. Other retail prices were generally steady.
ELEVENTH DISTRICT—DALLAS

Eleventh District economic activity remained fairly strong in August and early September. Most manufacturing and business service firms said they were operating at high levels, but reports were mixed, and there were some signs of softness. Retail sales continued to be weaker than in the first half of the year, but sales had strengthened slightly for some stores since the last report. Construction and real estate activity remained at high levels, and bankers said loan demand continued to be strong. Oil field activity continues to increase rapidly. Agricultural conditions remain very difficult; hot, dry weather has destroyed crops, impeded livestock production, raised costs, and delayed land preparation for fall planting.

Prices. Most price reports were unchanged or lower than six weeks ago, with the exception of energy prices, which were higher. Labor markets remained tight in many industries. Prices were unchanged or lower for most manufactured products, such as metals, cement, concrete, wood and lumber. Cement and lumber prices were being pushed down by increased imports. Brick producers, however, have increased their selling prices by 4 to 6 percent to pass along a portion of higher natural gas costs, but their orders are booked in advance so they do not expect to start collecting this increase until December. Food producers reported that broccoli continues to be in oversupply, and its price is falling. However, prices are up for a range of produce coming from Mexico. Office rental rates remained unchanged but industrial rates are up slightly, partly because increased construction costs (concrete, labor, land and steel) are pushing through to lease rates, according to respondents. Retailers reported no change in selling prices, but some said that markdowns are greater than a year ago. Most retailers do not see upward cost pressures on the horizon. Auto dealers said special financing and factory incentives are helping offset higher interest rates. Strong demand and very low inventories pushed up energy prices. West Texas Intermediate crude prices rose considerably over the past six weeks, and inventories reached the lowest levels in over two decades. Inventory levels for oil products also are low, helping push up
prices. For example, heating oil inventories are over 40 percent below the levels of last year. Natural gas prices continued at extremely high levels, with inventories at about 15 percent below last year.

Petrochemical producers report that margins are being squeezed because large inventories are preventing them from passing higher natural gas costs on to selling prices. For ethylene, the higher inventories are partly the result of new capacity coming on line and partly due to slower growth in demand. Inventories have built up significantly for polyvinyl chloride.

Manufacturing. Manufacturing activity continued to show signs of softness, although most industries are still operating at high levels. Demand has been mixed for construction-related materials, such as concrete, cement and metals. Cement sales have been strong for oil wells and highway construction but have softened in some areas, partly because hot temperatures limited the time that workers could be outside. Brick sales rebounded some after slowing in June and July; while sales are considered “excellent” they remain below the levels of the first half of the year. Sales of fabricated metals were also mixed, with some contacts reporting increased construction-related demand while others reported some softening in sales. Primary metals producers reported a slight slowing over the past few weeks. Demand for paper and food products was unchanged. Electronic equipment manufacturers say demand has flattened at high levels. Growth in personal computer sales remained “good” but has slowed slightly, according to contacts. There was more caution about the outlook for the next twelve months because planned capacity growth and a recent moderate increase in inventories for some types of semiconductors may lead to an acceleration in price declines for semiconductors next year. Demand for lumber and wood products continued to be strong, and transportation manufacturers reported solid growth in demand. Apparel producers said sales growth was up, and some have increased inventories in anticipation of stronger sales. Refineries were operating at high levels of production and reported strong demand and profit margins. Demand for petrochemicals softened slightly, and some plants have been shut down, such as those producing chlorine and methanol.
Services. Demand for business services remained strong, but there continue to be signs of softening. Temporary firms reported generally robust demand, although the strength of demand varied between firms; some contacts reported weakness from construction and manufacturing industries, while other firms continued to see strength from manufacturing. Legal firms also reported continued strong demand but, again, responses had some areas of softness. Transportation firms said demand was still strong, with airline, trucking and rail all reporting continued strength or stronger activity.

Retail Sales. Retail sales continued to grow at a weaker pace than in the first half of the year, according to contacts, but there were signs that sales growth was no longer decelerating. Generally, discount stores reported better sales and more optimism than department stores, although apparel sales were weak at most stores. Contacts did not report problems with inventory, even for those reporting sales declines. Auto sales rebounded in mid-August after flat sales in June and July.

Financial Services. Loan demand continued to be strong, while deposit growth and lending activity remained stable. Deposit growth remains a constraint on loan availability. Auto lending remained the fastest growing category and real estate lending the slowest. There were no concerns about credit quality, although a few respondents mentioned that there is still enough liquidity available to drive competition between institutions and push down margins.

Construction and Real Estate. Construction and real estate activity remained at high levels. Residential markets and homebuilding were strong. Nonresidential markets were also strong, particularly in the major metropolitan areas. Construction of all types of properties was up significantly according to contacts, who said that businesses are rushing to fill any vacant buildings. Demand was cited as particularly strong from “dot.coms.” Some analysts report that fears of overbuilding have vanished, while others are still concerned about the Dallas area office and retail markets. Real estate investors said there was still some difficulty obtaining financing, but financing is generally available at slightly increased rates. Despite tremendous activity in the single-family market, new apartment construction in the Dallas/Fort Worth area has dropped sharply.
**Energy.** Drilling activity continued to increase rapidly, with the U.S. rig count surging over 1000. Gas-directed drilling still accounts for over 80 percent of U.S. drilling. Offshore activity remained strong, and the rates charged for rigs were rising quickly. International activity was also rising quickly but remained well under the levels of the 1997-98 peak. Weak international drilling has allowed U.S. exploration to rise faster than had been expected, but shortages of people and equipment are limiting further growth in drilling activity.

**Agriculture.** Hot, dry conditions continued to deplete soil moisture, ravage crops and cause delays in land preparation for fall planting. The Texas cotton crop is being called a disaster; one million acres of the usual 6.3 million planted has been abandoned and more is being lost rapidly. The loss of the cotton crop is expected to affect gins, and other small businesses. Pastures are very dry, and livestock producers are giving supplemental feed, hauling water to livestock, and culling herds. Many municipalities remained under strict water rationing, and in some rural locations, water was being hauled for home use.
**Summary**

Reports from contacts indicate overall solid performance across the Twelfth District economy in recent weeks. District retailers reported moderate sales gains and service providers noted an acceleration in growth above an already rapid trend. Manufacturing activity in the District picked up slightly, boosted by strong demand for high-tech products. Reports from District agricultural producers generally were favorable. Residential and commercial real estate activity remained at high levels, although slower home sales tempered growth in construction in some states. District financial conditions remained healthy, with intense competition for quality borrowers. Respondents reported that surging energy costs and rising employee compensation were beginning to damp profits, as competitive pressures kept producers from passing increased costs to consumers.

**Wages and Prices**

Labor markets remained tight throughout much of the District, particularly for workers with financial, computer, or other technical skills. Recruiting and retaining employees remained difficult for firms in most industries. Rapid employee turnover and rising wage and benefit bills reportedly are beginning to temper profits, encouraging many firms to invest in labor-saving technologies.

With regard to prices, contacts noted that increased fuel and energy prices continued to affect production costs in a wide variety of industries. Surging electricity prices over the last several months prompted aluminum producers in the Pacific Northwest to curtail production and
boosted irrigation and greenhouse costs for many agricultural producers in the District. Contacts noted that rising electricity prices also have raised operating expenses at hotels, theaters, and amusement parks, particularly in San Diego. Higher fuel prices have prompted freight companies to impose surcharges and caused merchandise vendors to ask wholesale customers to pay separately for shipping. Despite rising costs, contacts noted that competitive pressure has prevented most producers from raising prices of final goods and services.

**Retail Trade and Services**

District retailers reported modest sales growth in recent weeks. In California and the Pacific Northwest department stores and discount retailers posted moderate sales growth, while apparel and electronics retailers reported flat sales. In the Intermountain states, vehicle sales were flat. Contacts throughout the District noted that high gasoline prices continued to damp demand for SUVs. Overall, District retailers reported adequate inventory levels and few problems obtaining merchandise from suppliers.

Service industry respondents in most District states reported strong growth. Demand for telecommunications, data communications, and cable television services picked up in recent weeks, producing material shortages, particularly for digital devices. Demand for software and information processing services intensified recently, as businesses resumed work on information technology projects postponed during Y2K and looked to satisfy unmet labor needs in part with technology. Container traffic through the Ports of Long Beach and Los Angeles accelerated during the survey period, lifting port activity to record highs. In California and Hawaii, strong demand for hotels pushed occupancy rates up and boosted room prices.
Manufacturing

Manufacturing contacts throughout the District reported generally solid conditions. Contacts in District aircraft, biotechnology, and semiconductor industries reported strong sales growth. Strong demand for semiconductors further increased capacity utilization rates, prompting some producers to accelerate scheduled expansions. Respondents in Washington noted that improved aircraft sales have slowed the rate of layoffs at Boeing; however, demand for component parts from local suppliers reportedly remains weak. District aluminum and steel manufacturers continued to be hindered by rising energy costs and strong import competition. Contacts in the Pacific Northwest reported layoffs among a number of aluminum producers.

Agriculture and Resource-related Industries

District agricultural producers reported generally favorable conditions during the survey period. District farmers reported good growing conditions and moderate growth of foreign demand. Contacts expect strong corn and cotton yields; however, since prices for these commodities remain low, farmers are concerned about future profitability. Stable prices for beef cattle have benefited District ranchers in most states, although dry weather in Arizona and Oregon has resulted in unplanned herd reductions.

District energy producers reported strong demand for oil, natural gas, and electricity. Fires resulted in the closure of two coal mines in Utah and increased demand for coal from remaining mines. As investment in energy projects has increased, contacts reported difficulty obtaining drilling rigs and extraction services.
Real Estate and Construction

Real estate and construction activity remained at high levels in most District states, although slower home sales have cooled construction growth in some states. In contrast, demand for commercial real estate remains high, particularly in California, where low vacancy rates and rising rents have spurred some speculative construction activity. Respondents in Arizona, Hawaii, and Utah also reported high levels of commercial construction activity. The strength of construction demand has produced some material and labor shortages. For example, builders in Arizona reported back-orders of steel and delays in receiving telephone service and in California shortages of skilled workers reportedly have delayed completion of a number of projects.

Financial Institutions

District contacts reported generally favorable financial conditions in recent weeks. Contacts at financial institutions in California, Utah, and Hawaii reported strong loan demand and deposit growth. Credit is readily available in these states, and there is stiff competition for quality borrowers. In contrast, financing availability reportedly tightened for Internet-related start-up firms in California.