Summary of Commentary on

Current
Economic
Conditions

by Federal Reserve District

July 2001
SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS

BY FEDERAL RESERVE DISTRICTS

JULY 2001
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SUMMARY*

Reports from most Federal Reserve Districts point to slow growth or lateral movement in economic activity in June and July. Retail sales generally were sluggish and frequently below expectations, despite substantial discounting on a wide range of consumer goods. Manufacturing activity in nearly all sectors and regions declined further in recent months as producers adjusted to weak domestic and foreign demand and worked through accumulated inventories. Sustained weakness in the manufacturing sector spilled over to other businesses, with many Districts indicating declines in demand for office space and trucking and shipping services. In contrast, residential real estate markets remained stable and even expanded in some areas, with the relative strength of the sector attributed in part to lower mortgage interest rates. Agricultural producers continued to struggle against low prices, weak exports, higher energy costs, and the weather, although some regions reported improvement in growing conditions since the last survey period. Financial institutions across the country reported reduced demand for a wide variety of loans, tighter credit standards, and stable-to-deteriorating quality of existing loans and leases; residential mortgages were the notable exception to these trends.

Continued slow economic growth loosened labor markets and eased wage pressures in most Districts in June and July, but rising benefit costs continued to add to compensation costs. Prices for energy, fuel, and many material inputs fell in most regions. Falling input costs and stiff domestic and foreign competition kept prices of most consumer goods in check.

* Prepared at the Federal Reserve Bank of San Francisco based on information collected before July 30, 2001. This document summarizes comments received from businesses and other contacts outside of the Federal Reserve System and is not a commentary on the views of Federal Reserve officials.
Consumer Spending

Retail sales generally remained weak in June and July, although there were scattered reports of a pickup in sales. Boston, Chicago, Cleveland, New York, Richmond, and San Francisco reported sales below expectations and well beneath comparable store sales for the same period last year. Atlanta, Dallas, Minneapolis, and St. Louis noted a slight pickup in sales since the last survey period, though sales were flat to down compared to last year. Kansas City and Philadelphia reported flat sales during the last survey period. The weakness in retail sales was broad-based across product lines and types of outlets. Within the sector, sales were strongest at large discount retailers, though many other retailers were offering discounts to promote sales. Auto sales apparently fared better than other areas of consumer spending in some Districts. Districts attributed the better-than-expected sales in part to manufacturer incentives and lower financing charges.

Districts reporting on inventories at retail outlets indicated that most businesses were able to keep stocks in balance. Still, there were scattered reports of retailers canceling orders or asking manufacturers to warehouse deliveries until existing inventories are cleared. Contacts noted that orders for back-to-school and Christmas merchandise were running lower than last year in anticipation of slower sales.

Services and Tourism

Districts reporting on the services sector indicated continued weak demand in June and July. In Dallas, Cleveland, and San Francisco, demand for business services, including advertising, computing and data processing services, and temporary employment agencies, was stagnant or declining in recent months, resulting in employment reductions in some areas. In Cleveland and Dallas, transportation and shipping activity declined further in June and July, as
businesses continued to reduce orders in an effort to control inventories. Accounting, insurance, and legal firms also saw demand soften in some Districts, prompting more rigorous monitoring of payroll costs and other expenses. Dallas noted a pickup in demand for legal services related in part to energy market developments and increased bankruptcy filings.

Layoffs and slower economic growth reportedly damped tourism in many parts of the country. Many Districts noted that airline bookings, hotel occupancies, and hotel room rates fell in recent months. However, hotels principally struggled with a decline in business travel as companies worked to cut costs in light of slower earnings growth.

Manufacturing

Manufacturing activity declined further in recent weeks, as producers responded to ongoing weakness in demand and worked to balance inventories. Reports of reduced work hours, lost overtime, forced furloughs, planned shutdowns, and layoffs were pervasive. Nearly every District reported that new orders and shipments for durable and non-durable manufactured products remained sluggish during the recent survey period, with declines recorded for producers in some sectors. Weakness was especially evident among producers of apparel and textiles, computers, semiconductors, steel, and telecommunications gear. In addition to conditions in the domestic economy, Districts attributed the current malaise in manufacturing to softening international demand for U.S. goods— particularly in Europe and Asia. On the up side, Districts reported that producers were making progress in running down their excess inventories.

Real Estate and Construction

Conditions in commercial real estate markets softened in several Districts in June and July, in keeping with slow economic growth. Nine Districts reported increased office vacancies in metropolitan areas in the second quarter, with signs of additional weakening in July. A
number of Districts noted that the swing in market conditions was due in part to an increase in sublease space. The rise in vacancies reportedly made it a buyers market in some metropolitan areas. However, most Districts noted little movement in posted lease rates, with landlords opting for one-time inducements such as a free month’s rent or property upgrades to attract tenants. In San Francisco, where commercial lease rates have declined, contacts noted that prospective tenants appear to be waiting for rates to fall further. Rising vacancies damped new construction activity in a number of areas.

Districts indicated that residential real estate markets generally remained stable in recent months, though signs of weakness were apparent in some regions. Atlanta, Cleveland, Minneapolis, New York, Richmond, and St. Louis reported continued brisk demand for low and moderately priced homes; one District reported that homes “priced right” continued to sell quickly, often attracting multiple bidders. In Boston, Chicago, and San Francisco, demand remained stable but weakness in the high-end market was noted. Dallas and Kansas City reported flat to slower growth in home sales, with some concerns about rising inventories. In general, Districts attributed the continued strength of residential real estate in part to lower mortgage interest rates.

Agriculture and Natural Resources

Reports on agricultural conditions were mixed across the Districts. Atlanta, Kansas City and St. Louis highlighted generally good conditions in their regions, with some crop yields coming in better than expected. Dry weather was having an adverse effect on farmers and ranchers in the Cleveland, Chicago, Dallas, and Richmond Districts. San Francisco reported favorable growing conditions, but ongoing struggles against low prices, weak export demand, and high energy costs.
Banking and Finance

Loan demand was flat to down in most Districts in recent weeks. However, the composition of the slowdown differed by region. In Kansas City and Philadelphia, commercial and industrial lending picked up, while consumer lending declined. Declines in lending in Atlanta, Chicago, and Richmond were largely in the commercial sector. In St. Louis, all types of loans declined, although the most pronounced reductions were in consumer borrowing. In Cleveland and New York, loan demand remained relatively flat, as both consumers and businesses curtailed borrowing. Several Districts reported increases in home mortgage lending.

Overall, Districts characterized financial markets as cautious, with both borrowers and lenders pulling back in response to economic uncertainty. There were some reports of deteriorating credit quality, particularly for credits to manufacturing and agricultural businesses. A number of Districts reported that lenders had tightened standards in recent weeks, particularly for business loans.

Labor Markets, Wages, and Prices

Most Districts reported that conditions in labor markets remained steady or loosened somewhat in recent weeks. Layoffs in many high-tech manufacturing and service firms boosted the number of highly skilled workers applying for jobs through temporary employment agencies. Employers in a number of Districts noted greater ease in finding and keeping qualified workers.

Looser labor markets in most Districts helped to contain wage pressures in recent months. However, benefit costs rose, particularly for health and other forms of insurance coverage. Rising insurance premiums and the slowing economy reportedly prompted some employers to reevaluate benefit packages. Kansas City reported that firms were working on ways to reduce employee benefits such as free parking and health club memberships.
Fuel and energy prices fell in June and July in most Districts, lessening the burden on businesses and easing pressure on consumer budgets. Lower gasoline prices allowed shippers and truckers to reduce or remove fuel surcharges imposed earlier this year. Lower energy costs also contributed to price declines for a number of manufactured goods. However, upward price pressure was reported for pharmaceuticals, various services, and single-family housing in some regions. In addition, retail electricity rates were up sharply in California in June, as previously authorized rate hikes took effect. In general, however, declining input costs and stiff domestic and foreign competition continued to restrain consumer prices.
The First District economy continues to slow. A majority of contacts in the retail and manufacturing sectors report declines in business activity compared with a year ago. Insurance companies say demand has slowed but not declined. Residential real estate contacts say housing markets across New England are strong although softer than a year ago. Prices for most goods other than housing are reported to be flat to down compared with a year ago. Most respondents indicate that they are stepping up efforts to cut costs.

**Retail**

Most retail respondents report that sales were flat or down during the May through July period compared with a year earlier. These results were generally worse than expected, yet inventories are mostly said to be close to desired levels. Most contacted sectors (discount retail, tourism, home and office furniture, computer and office technology products, office and art supplies) say consumer demand is anemic. However, sellers of building materials and hardware report modest growth in sales.

Employment levels and wage rates are mostly said to be holding steady. However, some retailers say that they plan to shrink employment through attrition or shift more toward part-time help. Most report that it is now much easier than last year to hire replacement help and seasonal workers. Retail contacts say that they are not raising selling prices and they are seeing only sporadic increases in vendor prices. Most indicate that their profit margins are holding; however, retailers selling technology products are discounting prices, which has reduced profit margins slightly compared with last year.

Retail respondents expect little growth in the economy in the next year, and most say that they are not expanding their operations in 2001. The mood is cautious; while they no longer expect a rebound in the second half, they hope for some improvement late this year.

**Manufacturing and Related Services**

Close to two-thirds of First District manufacturing contacts report that recent sales or orders are down from a year earlier; only about one-third report increases. Expectations about future revenues vary
considerably, but virtually all contacts are taking new steps to reduce costs.

Reports from makers of computer hardware, communications gear, and semiconductor-related equipment have deteriorated noticeably, and some of these contacts are not expecting much recovery until late 2002. Manufacturers of other types of equipment are less gloomy but nevertheless cite examples of customers eliminating discretionary purchases or demanding concessionary terms. One contact that sells a broad range of parts and supplies to manufacturers describes the environment as the worst in 30 years. On the other hand, several manufacturers are heartened that their business, while down from a year ago, does not appear to be deteriorating further. These include makers of paper products and residential construction components.

By contrast with the general trends, demand for pharmaceuticals, medical equipment, publications, aircraft parts, and defense equipment has continued to increase. However, several contacts point to vulnerabilities in aviation-related business, and one producer of medical equipment has noticed a recent weakening. Across a range of industries, manufacturers are concerned about deteriorating conditions in foreign markets, particularly Europe and Latin America.

Respondents say their selling prices and materials costs generally are flat or down. Some indicate that their corporate customers are pressuring them for more favorable terms. They in turn are applying similar pressures on their suppliers.

Almost all manufacturing respondents report initiatives to control or reduce labor costs. Actions vary from company to company but include layoffs, furloughs, controls on new hires, and restrictions on pay increases. Most contacts say that capital spending is slated to be reduced this year. Many report efforts to cut back on information technology expenditures.

Residential Real Estate

Residential real estate markets in New England are still strong, although signs of softening are emerging. The number of listings has begun to grow slowly, while the number of sales is starting to decline. Real estate contacts indicate that the lower half of the market still enjoys very robust activity
because low interest rates stimulate demand among potential buyers, while the level of activity at the top of the market has slowed.

Contacts in Rhode Island report that the market is as strong as ever, with most new listings selling very quickly and the average sales price up from last year. In Vermont, the average sales price is slightly higher than a year ago, but prices of new properties coming on the market are the same as those of existing properties, indicating that prices have stabilized. New Hampshire contacts say the average selling price rose 10 percent over the past year, but the number of sales dropped 12 percent during the same period. Some respondents attribute the slowdown to seasonal rather than cyclical changes.

Insurance

Insurance respondents report modest sales growth in the second quarter of 2001, similar to first-quarter growth. In some cases, demand was generally off, while in others, falling demand for financial products such as annuities and mutual funds offset increased insurance demand. One respondent sums up the reasons for the slowdown as “the general economy, uncertainty over estate and other taxes, and volatility in the financial markets.” One major health insurer reports a large fall-off in revenues as they reevaluate their service offerings in light of profitability changes.

Most insurance contacts seem relatively downbeat about their company’s outlook. One respondent said that they are “more uneasy” now than three months ago because they had expected to see evidence of an upturn in the economy by now. Another said that they are “no more pessimistic” now than earlier this year. Because of falling or lower-than-expected revenues, most respondents are in the process of cutting costs. Some companies have made large workforce cutbacks (3 to 12 percent), while others are instituting employment freezes with the possibility of cutbacks in the near future. Most insurance contacts say capital and technology spending is relatively flat.
SECOND DISTRICT—NEW YORK

The District’s economy has been generally sluggish since the last report, with the notable exception of housing. Overall business costs remain subdued, aside from sharp increases in utility and medical costs, and prices of final goods and services appear to have decelerated. Labor markets have eased, especially in manufacturing and financial services; however, hiring activity remains fairly brisk in a number of other service industries. Retail business remained soft in June and July, with general merchandise chains reporting year-over-year declines in comparable-store sales. A number of contacts say they are making a concerted effort to reduce inventories. Retail prices are said to be down slightly.

Housing markets throughout the District continue to show considerable strength, with second-quarter selling prices in most areas running well ahead of a year ago. In contrast, commercial real estate markets slackened substantially in the second quarter—particularly in New York City, where availability rates have risen sharply and asking rents have fallen. Similarly, Manhattan’s hotel occupancy rate fell to a six-year low in the second quarter, while room rates registered their steepest decline in nearly ten years. Finally, bankers report an increase in consumer delinquency rates, steady loan demand, and some tightening in credit standards, except on home mortgages.

Consumer Spending

General merchandise retailers indicate that sales were below plan in both June and July, and that same-store sales were generally lower than a year earlier; however, within the group, discounters tended to fare somewhat better. Apparel sales were mixed but generally weak, with women’s apparel a bit stronger than other categories. One large discount chain notes that more customers seemed to be opting for private-label and lowest-priced merchandise lines. Both furniture and soft-goods for the home were described as particularly sluggish. A major home-improvement retailer notes some improvement in the tone of business in June and July—with particular strength in sales of energy-efficient products—though sales were still described as anemic. Another contact noted a weather-related pickup in sales
of air-conditioners and lawn and garden merchandise.

One large retail chain reports a moderate but noticeable pickup in sales from customers who have received their tax rebate, based on a preliminary survey of shoppers. However, most retail contacts expect the current round of tax rebates to have only a modest effect on sales.

While a few contacts report that inventories are a little high, most describe current levels as satisfactory—largely due to steep markdowns. A number of retailers indicate a concerted effort to reduce inventories in response to diminished sales expectations, and most major chains are scaling back orders for the upcoming back-to-school and Christmas seasons. Both prices and merchandise costs were reported to be flat to down modestly, led by declines in apparel prices. A number of retailers say they are encountering rising costs of labor (especially medical insurance) and utilities.

**Construction and Real Estate**

Housing markets across the District continue to show vigor, though residential construction activity slowed somewhat in the second quarter. Multi-family housing permits fell substantially in June on a seasonally adjusted basis; for the second quarter overall multi-family permits fell by about a third from first-quarter levels and were more than 20 percent lower than a year ago. Most of the decline reflects a return to more normal levels of activity in New York City, following two boom years. Single-family housing permits also declined in June, and were down 5 percent in the quarter—compared with both the first quarter and a year earlier. A homebuilder in upstate New York indicates that business has been strong and that it is increasing production. In contrast, homebuilders in northern New Jersey also say that demand remains strong but that construction activity is being limited by high costs and a shortage of available land.

The market for existing homes has continued to be quite firm since the last report. According to separate reports from a leading New York City appraisal firm and a local real estate board, prices of prime Manhattan co-ops and condos continued to edge up in the second quarter. Compared with a year
earlier, selling prices were up considerably, although the number of transactions was down sharply. The market may have strengthened as the quarter went on, as a major Manhattan real estate firm reports that they sold more apartments in May and June than a year earlier, following sluggish activity in April; they also note that prices remained well above a year ago.

Single-family home sales across New York State were mixed but generally strong in the second quarter. The Albany and Buffalo areas, New York City and Long Island showed particular strength, with both unit sales and selling prices up substantially from a year earlier. In contrast, in the Rochester area, both unit sales and average selling prices were down from a year ago. There were signs of cooling in high-priced Westchester County—unit sales were down sharply and price appreciation slowed from last year’s double-digit rate. More generally, across the District, realtors indicate that while the high end of the housing market has shown some softening, the market for starter homes is particularly strong.

In sharp contrast with the residential sector, commercial real estate markets softened further in the second quarter. Manhattan’s office market has slackened substantially: availability rates jumped by nearly two percentage points in the last three months and asking rents declined at a nearly 10 percent annual rate. The most dramatic weakening has occurred in the Midtown South area, where strong leasing demand from dot-coms had driven up prices in recent years.

Office markets in adjacent suburban areas have converged over the past year, with the slackest areas strengthening and the tightest areas weakening. For example, Westchester County’s office vacancy rate fell from 15 percent in mid-2000 to 12 percent at the end of June. Over the same period, neighboring Fairfield County’s rate jumped from 7 percent to 12 percent. In Long Island and northern New Jersey, vacancy rates have risen by about 2 percentage points over the past year, while asking rents were flat to up moderately. In northern New Jersey, a substantial volume of office space is expected to come onto the market in the year ahead, reflecting downsizing in the telecommunications industry.
Other Business Activity

A major New York City employment agency says that the local job market for mid-level office workers is still fairly strong; however, there is less of a sense of urgency to hire than earlier this year and salaries, which had been rising at a double-digit rate, have leveled off. This contact also reports that financial services firms have scaled back recruiting substantially, but that hiring remains fairly brisk at a variety of other service industry firms—especially law firms.

Manhattan’s hotel occupancy rate (seasonally-adjusted), fell to a six-year low of 80 percent in the second quarter, down from 84 percent in the first quarter and 89 percent a year ago. The average room rate was little changed on a quarterly basis but has fallen by about 5 percent over the past year. Although both occupancy rates and room rates are still considered to be at high levels, the declines over the past year are the steepest since 1991.

A number of New York State manufacturers indicate that weak export demand and increased import competition (mainly from Asia) are hurting overall sales. In addition, some firms are being hurt by a falloff in demand from customers in the telecommunications, high-tech, and steel industries.

Financial Developments

Loan demand was little changed since the last report, according to the latest survey of Second District banks. Demand for refinancing also leveled off, following widespread increases in the past few surveys. On the supply side, bankers continued to report tightening standards for all types of loans except residential mortgages. Both loan rates and deposit rates continued to fall across all categories since the last report. Delinquency rates increased noticeably on consumer loans and moderately on nonresidential mortgages; however, there was a moderate decline in delinquencies on home-mortgages.
THIRD DISTRICT – PHILADELPHIA

Third District businesses on the whole reported little or no improvement in July compared with June. In some sectors activity was below year-ago levels. Manufacturers reported declines in shipments and orders during the month. Retail sales were mixed. General merchandise sales were flat compared with June and down from July of last year, but sales of automobiles increased from June to July. Bank loan volumes edged down during the month, but mortgage refinancing remained strong. Tourism activity throughout the District has been slower this summer than last, and business travel has declined sharply from a year ago.

Businesses in the District generally expect some slight improvement in the fall. Manufacturers forecast an increase in orders within the next six months, although they are planning only small increases in employment and working hours. Retailers look for a pickup in sales in the fall, but most do not anticipate significant gains. Bankers expect lending in all major credit categories to be virtually flat for at least several more months.

MANUFACTURING

Third District manufacturing activity continued to decline in July. Shipments from plants in the region fell, and new orders edged down. The falloff in orders was slight in most manufacturing sectors, but declines were widespread among producers of transportation equipment, metal products, and wood products. Manufacturing firms in the region continue to experience declining demand from foreign countries. Several noted significant easing in orders from Europe. Firms that supply the telecommunications industry with a variety of products continued to report very weak demand from that sector. On balance, manufacturers scaled back working hours and reduced employment during July. Manufacturers indicated that prices of inputs were nearly steady in July, and prices for the products they make moved down. Nearly six out of ten of the firms polled in July reported that their inventories were above desired levels. Four out of ten indicated that their inventory levels were satisfactory. Excess inventories appeared to be especially prevalent among producers of wood products, furniture,
industrial materials, and primary metals. Overall, firms in the region plan to reduce inventories in the next six months by keeping production low and shipping from inventory.

Manufacturers expect business conditions to improve during the next six months. Firms in nearly all of the major manufacturing sectors in the region expect demand for their products to increase, although makers of wood products, industrial machinery, and instruments anticipate further declines in orders. Area manufacturers forecast a rise in order backlogs in the next six months, but they plan only slight increases in employment and working hours, on balance.

RETAIL

Retail sales in the Third District in July were generally steady, but down from the level in the same month last year. Overall, retailers contacted for this report indicated that their sales have been flat in recent weeks. Merchants said customer traffic has been slow and shoppers have curtailed impulse purchasing. Reports from stores in the region indicated that, on balance, general merchandise sales in the region in July were about 5 percent below the year-ago rate, in current dollars. Several stores reported steeper year-over-year declines. Some merchants noted that summer merchandise had not been in strong demand for most of July because the region's weather had been cooler than normal. Higher temperatures toward the end of the month did little to boost sales, however, and stores have begun their usual clearance sales of summer goods. Store officials have been cautious in sales plans since spring, and they have generally kept inventory levels from becoming excessive.

Store executives see few signs that sales might strengthen significantly. Most of those contacted for this report anticipate a slow recovery in sales during the fall selling season. Stocking of fall merchandise has been restrained, and some retailers expressed concern that planned inventories might not be adequate if consumer demand increases strongly.

Auto dealers generally indicated that sales picked up a bit in July compared with June. Sales of imported automobiles have been relatively stronger than sales of domestic automobiles. Manufacturers' incentives continue to support a relatively high sales rate in
most parts of the region, but some dealers in areas where unemployment has increased reported recent declines in sales.

FINANCE

Total loan volume outstanding was edging down in July at Third District banks contacted for this report. Bank lending officers indicated that there had been some growth in commercial and industrial lending, but declines in consumer and real estate lending. Some bankers indicated that a significant portion of their new business loans were for buyouts or reorganizations of local firms rather than for expansion. Consumer lending of all types has moved down, although mortgage refinancing activity has continued at a fairly high level.

Bankers in the Third District expect overall loan volumes to be nearly flat for at least the next few months. Commercial bank lending officers expressed heightened caution with respect to the creditworthiness of potential business borrowers. Nevertheless, some banks are actively seeking new opportunities to extend credit to well-capitalized businesses in all industries, including commercial real estate.

TRAVEL AND TOURISM

Travel and tourism officials in the Third District reported that tourist and recreational business throughout the region has edged down from last year. Lodging occupancy has not achieved last year's levels in most resort areas. Reports from hotels and other lodging businesses in some areas indicated that advance bookings of rooms have been declining since the summer vacation season began. Travel and visitor bureaus in the region generally noted significant declines in business travel compared with last year. In particular, attendance at recent conventions and other business meetings has fallen below anticipated levels.
General Business Conditions

The Fourth District economy continues to move laterally, with large gains in a few areas offsetting modest declines in many sectors. Weakness in the region remains centered in manufacturing, although industrial softness has begun to exert downward pressure on other industries, such as shipping and construction.

Unemployment remains low, although District labor markets have loosened considerably this year and wage growth is reported to have moderated. Demand for temporary workers is off 10 percent to 15 percent from the levels seen in May and June. This falloff, combined with a seasonal increase in students seeking summer work, has created an excess supply of temporary workers.

Manufacturing

Conditions in the manufacturing sector continue to deteriorate. Steel orders remain soft and inventory levels are still high. Moreover, a recent slowdown in the construction and appliance-manufacturing industries is expected to exacerbate the already weak demand for steel. Steel prices have fallen at least 25 percent since a year ago, and recent attempts by some steel makers to boost prices 5 percent per ton have not stuck. Computer and telecommunications firms have also been hard hit.

Elsewhere in manufacturing, orders, production, and employment have shown little overall growth and overtime at many firms has been cut. Sources are not optimistic that industrial activity will improve soon; accordingly, capital outlays in manufacturing are well below levels seen a year ago.

Retail Sales

Retail activity in the District is mixed, although signs of weakness appear to outweigh signs of strength. While a few chain stores report extremely strong sales, most others appear to be faring poorly. Home decorative merchandise, floral and nursery goods, and some apparel items are selling well, but sales in most other categories remain
soft. Heavy price discounting is under way to help boost sales and thus slow rapidly rising inventories. Most retail contacts are pessimistic about conditions in the immediate future and see the possibility of sales declines through the back-to-school season.

Aggressive manufacturer incentives helped to bolster sales at District auto dealers in June—the highest month on record for many dealers. Year-to-date sales (through June) appear reasonably strong, and dealer profits are on the rise. Still, sales activity appears to have peaked in June as the effectiveness of pricing programs waned. In general, auto sales were down between June and July, and additional price discounts are expected in August as manufacturers prepare inventories for the new model year.

**Construction**

The sustained strength of home sales this year continues to surprise District home builders. Recent new home construction levels compare favorably with the historic peaks achieved in the first half of 2000. However, some firms report less customer traffic than this time last year.

Most commercial construction categories report weakness. Demand for office space, for example, seems to have dropped dramatically, particularly in central Ohio. Demand for retail and industrial space has fallen across the District, and vacancy rates for commercial building segments continue to rise. According to one source, the low level of new construction inquiries suggests that improvement in this sector is not imminent.

Overall, materials prices are said to be stable, although lumber prices have fluctuated widely and drywall prices have fallen further. Labor availability is mixed by trade: Unskilled workers are in ample supply, but shortages of framers, roofers, and masons have been reported.

**Trucking and Shipping**

Trucking and shipping tonnage in June and July was well off its level of this time last year. Shipping activity has felt the slowdown in manufacturing. Shippers note a larger-than-usual number of auto-related plant shutdowns and reduced production at machine tool, steel, and heavy equipment manufacturers. Shipments of retail goods are reported to have improved somewhat. Planned capital expenditures are down for the
year, and sources point to significant excess capacity in the industry. Bankruptcies among shippers have increased in the past year.

Fuel costs have dropped substantially since the last District report, leading to a reduction in energy-associated surcharges by shipping companies.

**Agriculture**

Recent dry weather has had an adverse effect on corn crops in the northern part of the District, and farmers expect yields to drop 5 percent to 10 percent as a result. Lower-than-average rainfall has led to poor growth in grazing pastures, forcing some farmers to dip into their winter feed supplies to maintain livestock. Dairy prices remain high, although production has fallen recently with the dry, hot weather—daily milk production is down as much as 10 percent for the season in some parts of the District.

Still, farmers appear to be faring better financially than last year at this time: Some have been able to make capital improvements to their farms this year, and very few banks report delinquencies on loans to farmers.

**Banking**

Fourth District banks report mixed developments in the aftermath of the recent interest rate reductions. Commercial loan activity is up for half of our sample, down in the other half; however, commercial loan applications have picked up in the past month or so. Consumer borrowing has been steady over the past six months, though some banks report growth in home equity lines of credit and new car lending.

There has been no significant change in the rate of loan delinquencies at District banks. Some bankers are concerned that recent increases in layoffs will pinch household liquidity. The spread between lending and deposit rates has widened slightly.
FIFTH DISTRICT—RICHMOND

Overview: The Fifth District economy advanced at a slow pace in June and July, with moderate growth at services firms accounting for most of the increase. Demand for services grew at a steady pace, although firms said they were watching expenses closely. Retailers reported sharp drops in sales in recent weeks and they reduced employment in July. Manufacturing shipments and new orders continued to skid. Most manufacturers, however, remained optimistic that shipments would pick up by the end of the year. Residential realtors reported little change in home sales, while commercial realtors said that leasing and construction activity continued to weaken. Prices of manufactured products were flat, and prices of services were modestly higher. In agriculture, hot and dry weather stressed crops and pastures in many areas of the District, although rain swept across much of the region in late July.

Retail: Retailers reported markedly lower revenues in recent weeks. Shopper traffic in District stores dropped and big-ticket sales contracted sharply. A big-box retailer in Gastonia, N.C. characterized sales as “stagnant” while a contact at a department store in the low country of South Carolina reported very slow sales and a cutback in payroll hours. An automobile dealer in the eastern panhandle of West Virginia described sales as "off a little bit" and noted that his company had reduced inventories. Employment in the retail sector declined in recent weeks and wage growth moderated. A big-box retailer in North Carolina said that his store had hired a number of people laid off from other employers in the area—some at substantially lower pay than they earned in their previous jobs.

Services: Many services businesses across the District reported moderately higher revenues in June and July. However, businesses were closely monitoring their overhead in an effort to preserve their operating margins. Several firms reported less business spending on corporate travel, including car rentals and hotel bookings. A travel agent providing business services in Greenville, S.C. said demand had dropped slightly, and a Baltimore, Md. financial services contact said there was concern among clients that the economy may not have bottomed out. A contact at an accounting firm reported discounting their prices to keep employees busy and said they are "managing the headcount" for the first time in several years. Employment in the sector was flat in June.
but picked up in recent weeks. Average wages were reported to be rising at a modest pace, but in some cases, more slowly than in recent years.

**Manufacturing:** The manufacturing sector continued to struggle in June and July, with continued declines in shipments and new orders. Production downshifted notably at firms in the textiles, lumber, furniture, paper, and electronics industries. A strong dollar and tenacious foreign competition continued to affect the textiles industry—a textiles manufacturer in North Carolina said that sales in recent months were the lowest in his memory and he is not optimistic about a turnaround soon. A plastics manufacturer in North Carolina also reported slow summer sales, but he expected a pickup in activity in the fall. Layoffs in the furniture and textile industries continued. On the price front, several contacts noted lower energy prices; overall prices paid for raw materials were flat in July.

**Finance:** District loan officers described lending activity as sluggish in June and July. A Richmond, Va. banker said that business lending was somewhat weak and she noted that many businesses were grappling with problems caused by a sputtering economy. She characterized business conditions as “choppy”—with “lots of companies doing well and lots of companies doing poorly.” A Greenville, S.C. contact also described lending as “somewhat weak,” and noted that he continued to keep a close eye on industries, including textiles, health care, and construction, that, in his opinion, might take a turn for the worse. He reported some increase in loan spreads as credit conditions tightened and fewer of his competitors were making loans at bargain basement interest rates. Residential mortgage lending expanded at a moderate pace—a South Carolina banker said that mortgage interest rates remained attractive and he expected lending to be moderately strong into the fall if rates do not rise.

**Real Estate:** Residential realtors and homebuilders reported little change in home sales since our last report. Several builders in the District said they had seen some strengthening in the market for low to middle-priced homes. A homebuilder reported “extremely brisk” sales in the Hampton Roads area. But a builder in Myrtle Beach, S.C. noted a weakness “that wasn’t there before” in sales in the mid-priced market. Sales prices remained generally steady throughout the District; an exception was a Greensboro, N.C. realtor who said that new home prices had fallen there. A contact in Richmond, Va.
said that prices of multi-family homes purchased as investment property had risen in recent months. Although most contacts reported little change in labor costs, builders in the Carolinas reported a substantial increase in lumber and drywall prices.

Commercial realtors across the District reported that leasing and construction activity generally continued to weaken in recent weeks. Office and industrial leasing was softer, reflecting sagging business conditions in the high-tech and manufacturing sectors. Contacts in Northern Virginia and Raleigh, N.C. generally reported a “tenant’s market” in office space due to the high-tech shakeout in those areas. Although contract rental rates were relatively stable across commercial sectors, effective rental rates eased in the office and industrial sectors and landlords offered various concessions, such as a month’s free rent, to entice tenants. New construction remained sluggish, but contacts in Charlotte, N.C. and Richmond, Va. were “guardedly optimistic” that construction activity would soon pick up. In addition, a contact in Baltimore said that commercial contractors’ “order books” were full for the next twelve to fifteen months.

**Tourism:** Tourism was flat since our last report. A contact on the Outer Banks of North Carolina reported a brisk business in beach property rentals in July. Hoteliers in both Virginia Beach and Myrtle Beach, however, said they had to discount prices early in the week of July 4th in order to increase bookings. In addition, a tornado struck a resort area in Myrtle Beach on July 6th and damaged several hotels and put a dent in that area’s tourist business. Tourism in Baltimore, Md. also received a setback from a bit of bad luck in July—a fire in a railroad tunnel caused the postponement of three Baltimore Orioles games at Camden Yards and the cancellation of bookings at nearby hotels.

**Temporary Employment:** Contacts at temporary employment agencies reported mixed demand for workers in recent weeks. A manager in Hagerstown, Md. said that activity at her agency was very weak and she did not expect it to strengthen over the next few weeks. She said her customers were experiencing very slow sales, which had curtailed demand for temporary workers. In contrast, a Charleston, W.V. contact said he had seen an increase in demand for temporary workers from the medical industry, in part because of the transcription services his firm now offered. An agency contact in Raleigh, N.C. reported a strong demand for analysts, research chemists, and technicians for
placement in the biotechnology and pharmaceuticals industries. Wages remained unchanged since our last report.

Agriculture: Generally hot, dry weather caused a substantial decline in soil moisture levels across much of the District and threatened crop development in June and most of July. However, significant rainfall occurred over many areas of the District in recent days, renewing hopes of higher yields. Livestock producers in Virginia reported that they might begin supplemental feeding soon because of poor pasture conditions. Some cattlemen in South Carolina weaned calves early because dry pastures had not provided adequate nutrition to nursing cows, but crops there were reported to be in generally good to excellent condition. Crops were also in good condition in West Virginia, where rain has been plentiful in recent weeks, and has caused flooding in some areas.
VI-1

SIXTH DISTRICT – ATLANTA

Summary: Contacts throughout the Sixth District suggest that economic activity was sluggish in June and July. Retail sales results were weak and volume remained supported by heavy discounting. The District's single-family housing market continued to perform well, whereas there was significantly less commercial construction than a year earlier. Manufacturing output continued to fall, resulting in further job losses. Loan activity was mixed; residential lending was strong, while commercial lending was slow. Business travel softened throughout the District, while leisure travel remained strong in south Florida.

Consumer Spending: Retail contacts across the District reported that sales during June were weak, but noted a slight improvement in early July. However, discounting has been widespread, and many retailers reported that inventories remained higher than desired. The outlook for retail sales in the third quarter remains subdued, but several retailers were hopeful that income tax refund checks would boost back-to-school sales.

Auto sales remained generally soft in June, although an increase in sales activity in early July was noted. Industry contacts indicated that regional sales for some manufacturers were weaker, and inventory levels higher, than in the nation as a whole. However, sales of luxury cars and some SUV models did improve in response to generous incentives offered by vehicle manufacturers. Sales of lower priced and fuel-efficient models have also improved.

Construction: Most areas of the District continued to post solid home sales in June, with particular strength in south Florida. Overall home construction and sales in June were near the high levels of a year ago. Neither real estate agents nor builders anticipate a sharp downturn in the market.
At the same time, the commercial real estate market continued to weaken. Sublease space has increased in both office and industrial markets across the District, resulting in higher vacancy rates and increased use of rental incentives. Office, industrial, and retail construction has slowed significantly and is expected to remain subdued through year-end. Few new commercial construction projects have been announced.

**Manufacturing:** Manufacturing continued to contract through July, and contacts noted that firms are holding back on capital investments because of the economic slowdown. Reports from Georgia, Tennessee, and Louisiana indicated ongoing problems in the textile and apparel sectors with mill closings and reduced factory workweeks. Further weakness was reported in the paper industry, although softwood price increases have stimulated the lumber industry. Some telecommunication firms continued to cut payrolls in response to reduced orders, and there was further vertical consolidation within the technology sector. In Louisiana, the petrochemical industry slowed because of higher input prices. Required environmental retrofits to refineries are producing some job growth, and vehicle production and component supply industries continued with expansion plans. Shipyards reported several new commercial and government contracts, whereas some pleasure boat manufacturers have cut production as a result of sluggish demand.

**Tourism and Business Travel:** Reports from the hospitality and tourism sector were mixed in June and July, with some strength in leisure travel and weakness in business travel. Contacts in south Florida reported that leisure travel remained healthy, equaling last year’s record pace. In central Florida, resort tax collections were down from a year ago and occupancy rates have fallen. In other parts of the District, contacts noted that convention business was sluggish because of shrinking corporate travel budgets.
Financial: Recent loan activity was mixed. Residential lending remained strong in parts of the District with continued growth in refinancing. However, auto-related installment lending has slowed, and commercial lending for new construction and equipment purchases remained slow. Reports indicated a modest thawing in venture capital activity during June and July.

Wages and Prices: Most reports indicated that companies are handling the slowdown by cutbacks in hours worked and by eliminating temporary workers. Outside of manufacturing, layoffs are still the exception rather than the rule. Wage pressures continued to subside. Some contacts are avoiding new hires and have not replaced employees who have vacated their jobs. In the technology sector, employers have become increasingly cautious in their hiring decisions.

Contacts cited few instances of price escalation in June and July. Reports indicated significant energy price reductions and continued price discounting at retail stores. However, lumber prices in July remained higher than a year earlier, and drywall prices increased sharply during July. House prices and healthcare costs have also continued to increase.

Agriculture: Orange production in Florida is seen reaching robust levels in 2001/02 due to ample rain that drenched parts of the Southeast during June and July. However, citrus producers continue to contend with tree disease problems that may yet limit yields. Local peanut growers are also facing increased uncertainty. The peanut farm quota system is under congressional review and peanut exporters have experienced strong price-competition from producers in China and Argentina.
SEVENTH DISTRICT—CHICAGO

Summary. Overall economic activity in the Seventh District was sluggish in June and July, and signs of any pickup in price inflation were generally absent from contact reports. Consumer spending in the Midwest was softer than in some other regions, and consumers appeared to be opting for less expensive goods and services. The availability of office space continued to increase in many areas as demand waned, while housing market activity remained relatively robust. While some key manufacturing industries have made substantial progress in working down excessive inventories, production remained very weak. Lending activity was mixed as household loan demand continued strong, particularly for mortgage credit, while businesses remained very cautious. Employers were finding it increasingly less difficult to hire and retain workers in most areas, and wage pressures subsided further. Crop conditions were generally less favorable than last year, and crop prospects and prices were expected to be particularly sensitive to weather developments for the remainder of the growing season.

Consumer spending. Consumer spending generally softened in June and July, and many retailers were lowering sales expectations for the fall. Many contacts noted that consumers were opting to purchase less expensive goods and services. A casual dining contact suggested that customers were “trading down the menu,” a large chain of specialty home items reported that shoppers were “buying at the lower end of the product line,” and discount chains continued to outperform general merchandisers. Several contacts suggested that sales results in the Midwest were not as strong as some other regions. Some stores were said to be canceling orders and there were reports that more retailers did not want to take delivery of merchandise, asking shippers to warehouse the items on trailers. One contact with a large trucking company suggested that there was “lots of inventory in the pipeline,” and many retailers were planning on heavier use of in-store promotional and discounting activity in coming months. While some merchants were gearing up for “tax rebate” promotions, a contact with one large national chain did not expect a significant increase in sales, but added “we do want to get our share” of whatever boost the industry may get. Light vehicle sales in the District were softer in June and July, and appeared to be weaker than national results. Contacts indicated that the tourism and travel industry was
actually benefiting from the economic slowdown as more of the region's pleasure travelers opted to stay closer to home. On the other hand, less business travel resulted in higher hotel vacancy rates in at least one major metro area, and airline bookings for the third quarter were "not looking good" according to one contact.

**Construction/real estate.** Real estate and construction activity was mixed in June and July. Building owners and commercial real estate contacts reported that office vacancy rates were increasing and the amount of sublease space coming back on the market (which is not reflected in vacancy rates) also continued to rise. With more space available in virtually every metro market, some landlords in softer markets began offering concessions, such as free months or upgraded amenities. Many landlords, however, were holding the line on rents with some noting that the demand was not there, regardless of price. Most contacts suggested that decisionmakers were reluctant to make long-term commitments until it was clear that overall economic activity was picking up. While leasing activity was down notably, sales of office buildings picked up in the Chicago and Indianapolis markets toward the end of the second quarter. Development of "big box" retail space continued virtually unabated, according to contacts, despite slower growth in consumer spending in recent quarters. The residential construction and real estate market continued to show remarkable resiliency in the face of slower economic activity and increasing joblessness. Most contacts reported that both new and existing home sales were off slightly from last year, but remained at high levels. This strength was generally attributed to very attractive mortgage interest rates. Virtually all of the builders and realtors contacted suggested that there was some slackening demand for higher-priced homes. Realtors in several markets noted that the number of listings increased in May and June, and homes that were "priced right" continued to sell quickly, often with multiple bidders.

**Manufacturing.** Overall manufacturing activity remained very weak, but contacts reported substantial progress in working down excessive inventories in some key industry segments. Nationally, light vehicle sales were relatively strong, although below last year's historic highs, and manufacturers were generally "happy" with inventories of both passenger cars and light trucks. The pricing environment remained competitive, however, and incentive spending picked up as automakers were reluctant to sacrifice market share to foreign nameplates.
Steel production continued to “bump along the bottom” but may have picked up modestly in July, according to one industry analyst. Contacts noted that the industry’s inventory correction was at or near completion, as inventories on the docks and those held by customers were at very low levels. A contact with a large maker of telecommunications equipment reported that excessive inventories had been worked down and should be at desired levels by the end of August. Despite continued weak orders, this contact had a “gut feeling” that the industry will begin recovering in the fourth quarter, although not at the strong rates of growth realized in 1999 and early 2000. By contrast, new orders for heavy trucks and heavy equipment continued to move lower in year-ago comparisons. The robust housing market helped keep shipments strong for gypsum wallboard makers, but the industry continued to be plagued by overcapacity resulting from large amounts of capacity that came on line over the last few years. Due in part to softness in office markets, shipments of office furniture were off sharply from last year, and one industry analyst suggested that 2001 will show the sharpest decline in shipments for the industry since records were first tallied in the early 1970s.

Banking/finance. Overall lending activity remained slow, as businesses remained very cautious in their borrowing and spending decisions. Business lending activity was generally described as “soft” and “sluggish.” There were a few new signs of deteriorating quality in some banks’ commercial loan portfolios, much of it related to conditions in the manufacturing sector. One lender noted a rise in “watch/problem” loans, while others reported adding to their loan loss reserves. This was to be expected, according to one banker, who said that twice as many of his customers were reporting losses on their balance sheets as last year. In contrast, one lender noted that demand from small and medium-sized businesses was “better-than-expected,” while another suggested that venture capital activity was picking up and was expected to continue to do so through the third quarter. Household lending activity was best described by one contact as “holding up.” Resilient strength in mortgage lending continued to surprise most bankers, despite some moderation in refinancing activity. Credit card borrowing picked up modestly and consumers were paying off less of that debt each month, according to one contact. There were mixed reports on consumer loan quality with some banks indicating that consumer defaults were
decreasing (partly as a result of the refinancing activity) while others suggested that delinquencies were increasing.

**Labor markets.** Demand for workers in the District softened further in June and July as firms tightened staffing to improve earnings, and most signs pointed toward continued soft demand in coming months. Many contacts reported less difficulty finding and retaining workers as the broad-based labor shortages of recent years had subsided. Manufacturing payrolls continued to decrease and layoff announcements remained prevalent throughout the District. Reports suggested that demand for financial, real estate, and legal professionals diminished in recent weeks as business deal-making activity slowed. Another report indicated that some employers were canceling or significantly curtailing fall recruiting activities at college campuses in parts of the District. At the same time, indexes of help-wanted advertising in local newspapers and surveys of hiring plans suggested that employers were reluctant to add to their payrolls early in the third quarter. While slacker labor markets helped ease wage pressures, reports continued of significantly higher health and other insurance costs.

**Agriculture.** Crop conditions in the Seventh District generally were less favorable than last year, when timely rainfall led to near record high crop production. The west and northwest portions of the District had been most seriously affected by an early wet spring, followed by damaging hot, dry weather recently. Crop conditions deteriorated sharply during the first three weeks of July, driving grain prices higher. Scattered rainfall in late July, however, eased the stress on crops in some areas, pushing prices back down before very hot and dry conditions returned at the end of the month. Crop prospects, and prices, will remain especially susceptible to weather vagaries for the remainder of the growing season.
Summary

Growth in the District economy remains slow, particularly in the manufacturing sector, which is experiencing almost no growth. Retail sales are flat when compared with a year earlier, although sales have picked up recently. Manufacturers report a further slowing of activity, with accounts of layoffs and downsizing now outnumbering those of employment increases. Residential real estate markets have remained strong, with sales and prices on the rise. Commercial real estate markets have been mixed. Loans on the books of District banks are down somewhat, although deposits have been rising. Loan delinquencies are up slightly, but remain at manageable levels. Crops are generally in good-to-excellent condition around the District. Recent rains have helped restore topsoil moisture levels.

Consumer Spending

Retail sales in June and July are reported to be flat when compared with those of the same period last year, although activity has been picking up since the beginning of the summer. High-end kitchen and laundry appliances, as well as tools and supplies for home improvement, have been posting strong sales. Automobile sales are mixed throughout the District. Dealers in Little Rock and Louisville report softness, especially in sales of domestic autos. Memphis car dealers, however, report recent sales increases, which they attribute to lower gas prices and interest rates, as well as to more generous manufacturer incentives.

Manufacturing and Other Business Activity

Growth in the manufacturing sector has slowed further throughout most of the District to a barely perceptible rate. Reports of layoffs and downsizing are now outnumbering those of employment increases. Firms in the furniture, chemical, and automobile parts industries have laid off workers or closed plants because of reduced demand. Managers in these industries do not expect sales to pick up until the first quarter of 2002. Steel manufacturers continue to face
low prices due to excess supply. The trucking industry continues to face driver shortages and some profit losses. A few trucking industry contacts have indicated, though, that the recent declines in gas prices have prompted a moderate resurgence of activity. Information technology and telecommunications firms are posting slow growth, with some layoffs and narrowing profit margins. The distribution and logistic services industry is also experiencing a downturn, as large direct mail and package handling companies decrease employee hours and eliminate jobs to cut costs. Contacts at some District power generation, food, and paper plants, on the other hand, are reporting moderate growth and expansion.

**Real Estate and Construction**

Residential real estate sales and median prices have continued to show strength in most parts of the District over the past six weeks, which contacts attribute to mortgage rates remaining relatively low and a usual seasonal upswing. Homes in the $150,000-to-$250,000 range have been the fastest sellers. A shortage of available homes still exists in several parts of the District; the Memphis region, however, has seen a mild increase in housing inventories. Real estate agents generally describe current markets as sellers’ markets and expect them to remain that way into the fall. Commercial real estate sales and leasing in the Memphis region have rebounded from a slow start at the beginning of the year. Despite a recent uptick in the demand for industrial space in the St. Louis and Louisville regions, a large amount of it is still available, creating a buyers’ market. A St. Louis contact has noted that the office absorption rate has risen recently.

Residential construction is steady in most of the District. With the market for skilled construction workers still tight in parts of the District, some contacts have recently noted a decline in the number of sub-contractor bids per project. In most District metropolitan areas, June monthly building permit levels are down from their relatively strong May numbers. On a year-to-date basis, more than half of the District’s metro areas have June permit levels that are up from a year earlier.
Banking and Finance

Total loans outstanding at a sample of small and mid-sized District banks are down modestly, falling 0.4 percent between early May and early July. This decline stems from weak consumer loans, which are down 1.3 percent over the same period. Commercial and industrial loans and real estate loans have remained essentially unchanged over the period, growing only 0.1 percent each. At the same time, total deposits at these banks are up 1.3 percent, continuing a trend that started in late 2000.

Several bankers report that loan delinquencies have been increasing, but remain at manageable levels. Bankers also have recently tightened credit standards somewhat, particularly for business loans. Many banks are looking into new programs and technologies to increase non-interest income and reduce non-interest expenses.

Agriculture and Natural Resources

The harvest of the District’s winter wheat crop is now complete. Several Illinois contacts describe the crop as disappointing; others in Illinois, however, consider it to be the best crop in several years. Early USDA estimates indicate that 2001 wheat production and acreage harvested are expected to be down by an average of almost 20 percent across District states.

The corn, cotton, soybean, and rice crops are generally in good-to-excellent condition in most of the District. In Missouri, however, the soybean and cotton crops are in only fair condition. Contacts in Kentucky and Tennessee report that the tobacco crop is in mostly good-to-excellent condition, despite minor disease problems.

Although most District states experienced hot and dry weather in early July, widely scattered showers later that month helped restore topsoil moisture to adequate levels, which enhanced development of the corn, cotton, soybean, and rice crops. That said, small pockets of dry soil persist in some areas of the southern part of the District.
Economic Activity in the Ninth District is subdued. Manufacturing, commercial construction, tourism and mining activities are down. Agriculture is mixed. Residential real estate, consumer spending and energy exploration are up slightly. Several companies announced layoffs; nevertheless, labor markets remain tight. Overall wage and price increases are moderate. However, significant increases are reported in home prices, and decreases are noted for gasoline and fertilizer.

Construction and Real Estate
Construction activity in the district is down slightly from a year earlier. Construction contracts awarded in Minnesota and the Dakotas dropped 7 percent for the three-month period ending in June compared with the same period last year. Vacancy rates for office and industrial space in the Minneapolis-St. Paul area have increased about 2 percentage points during the past year and are expected to increase by another 2 percentage points by June 2002, according to a commercial real estate firm. Lease rates in downtown Minneapolis are predicted to drop or remain flat. Representatives of commercial real estate firms report new construction has slowed from a year ago in Missoula, Mont., as several big box retailers are completing new stores.

Homebuilding activity is higher compared with last year. Housing units authorized increased 5 percent in the district for the three-month period ending in June compared with a year earlier, including a 26 percent climb in multi-family units. Home sales were up 6 percent for the first half of 2001 compared with a year earlier in the Fargo, N.D. area and are even with last year’s record pace in Sioux Falls, S.D. A banker in the Upper Peninsula of Michigan noted strong activity for new home purchases and construction, in part due to low interest rates. According to a building association representative, Minneapolis-St. Paul area builders are busy despite a 15 percent decline in permits for the first six months of 2001 compared with a year earlier.

Consumer Spending and Tourism
Overall district retail sales are level to up slightly. A major Minneapolis-based department store retailer noted that overall same-store sales in June were flat compared with a year earlier. A Minneapolis area-based retailer of women’s apparel reported same-store sales up 4 percent in June compared with the same period last year. Sales at a Minneapolis-area mall were up 4 percent for the first half of 2001 compared with the first half of last year.
Retail sales in rural Montana communities are sluggish. Auto sales are level compared with a year ago in North Dakota, according to an auto dealer association representative.

Tourism activity is down slightly from a year ago in many areas of the district. In the Upper Peninsula of Michigan an official said it appears that tourists are spending less in restaurants and stores compared with last year. In northwestern Wisconsin, tourism activity was slow in June but picked up in July to normal levels, said a Chamber of Commerce official. Visitor numbers were off at several major attractions in June compared with last year in South Dakota, including a 3.5 percent decrease at Mount Rushmore. Meanwhile, the tourism market in Montana is soft, according to a bank director.

**Manufacturing**

Overall manufacturing activity is down. A June purchasing manager survey by Creighton University indicated very weak new orders in Minnesota, level manufacturing activity in North Dakota and growth in South Dakota. As evidence, a ski-making facility in Minnesota will close and production will move overseas; a beverage dispenser producer and a drill bit manufacturer both plan to reduce production due to weak sales. A construction equipment manufacturer in North Dakota shut down for one week to reduce inventory levels. An air conditioner company plans to close a compressor facility in western Wisconsin. However, a pasta producer is building a new manufacturing plant in North Dakota, and a new saw mill is planned in the Upper Peninsula of Michigan. A geothermal heat-pump plant is under construction in South Dakota.

**Mining and Energy**

The energy sector expanded, while the mining industry contracted. District oil and natural gas exploration remains above last quarter levels. In addition, ethanol production is increasing, and a new South Dakota plant is under construction. Meanwhile, iron ore shipments in May were 10 percent below year-ago levels. Even though several iron ore mines restarted production after closing for a few weeks earlier this summer, a major mine plans to shut down for a few weeks this fall. Commodity prices have fallen for many metals. A Montana copper mine and an aluminum smelter are still closed. However, a Montana platinum/palladium mine remains at full production.

**Agriculture**

Certain agricultural prices are strong. The U.S. Department of Agriculture (USDA) indicated that June prices compared with a year ago are higher for milk, broilers, cattle,
hogs and calves, but lower for eggs and turkeys. In addition, a South Dakota bank director reported favorable hay prices. Even with the first cutting of the alfalfa crop essentially complete, a Montana director noted a sell-off in cattle herds due to high hay costs.

The USDA reported that corn and soybean crop progress is behind the five-year average in Minnesota, South Dakota and Wisconsin. In addition, about a fifth of the Minnesota corn and soybean crops are rated poor or very poor. In contrast, a North Dakota bank director noted favorable crop conditions, and the USDA reported North Dakota oats, barley, spring wheat and soybean progress ahead of the five-year average.

**Employment, Wages and Prices**

Several companies announced layoffs, and job openings are down. A major financial services company plans to cut as many as 1,000 jobs over the next 15 months; about 500 workers will be laid off at a district-based airline; and a computer firm will eliminate about 100 positions in Minnesota. In North Dakota, 35 telemarketing workers lost their jobs.

During second quarter 2001, 97,200 job openings were reported in Minnesota, representing a 3.8 percent job vacancy rate, down from 4.9 percent and 124,000 openings in fourth quarter 2000.

Even with a lower job vacancy rate and higher layoffs, labor markets still remain tight. Unemployment rates across the district are below historic averages. About 9 percent of nursing jobs in South Dakota are currently open due to a shortage. A direct marketer of credit and insurance services will expand its workforce by 200 workers in Minnesota.

Overall wage increases are moderate, with larger increases reported in some recent labor contract signings. Only 25 percent of respondents to a survey of manufacturers in Minnesota, Wisconsin and the Dakotas report increased wages between May and June compared with 47 percent a year ago. Manufacturing wages increased 2.7 percent for the three-month period ending in June compared with a year ago. Many schoolteachers in North Dakota will receive an average of a 6.1 percent increase in pay for the upcoming year compared with last year.

Price increases remain modest, with decreases noted in gasoline and fertilizer and significant increases in residential real estate prices. District gasoline prices were down about 10 to 15 cents in July compared with last year. Fertilizer prices have dropped about 15 percent from three months ago. The median home price in Minneapolis-St. Paul increased 12 percent in June compared with a year earlier.
TENTH DISTRICT - KANSAS CITY

Overview. The Tenth District economy weakened further in July. Manufacturing activity declined, construction and real estate activity slowed, and retail sales were flat. On a positive note, vehicle sales picked up following several months of decline, and the energy sector continued to perform well. In the farm economy, wheat yields in many areas were better than previously expected. District labor markets remained similar to the previous survey, with employers having a much easier time hiring most kinds of workers than earlier in the year. Wage pressures were minimal, and most prices remained steady.

Retail Sales. Retail sales remained flat in July and were down slightly from a year ago. Several contacts reported that while consumers continued to spend, they were becoming much more value-conscious and responding in many cases to large price discounts. Women’s casual clothing sold well, while dress clothes and home furnishings experienced a drop in sales volume. Retailers generally trimmed inventories in July and said they were satisfied with current stock levels. Managers expect to increase inventories of school supplies and children’s clothing by typical amounts in August in anticipation of back-to-school buying. Motor vehicle sales increased across most of the district in July, following reports of weaker activity in the previous survey. But the stronger activity only pushed auto sales up to around year-ago levels. In many places, the increase in activity came largely from sales of more fuel-efficient or diesel models of cars and trucks, and dealers in those areas planned to increase inventories of those models accordingly. Sales of SUVs and small trucks held steady, keeping dealers satisfied with inventories of those vehicles.

Manufacturing. Overall factory activity in the district declined again in July, as the number of firms operating at low levels of capacity utilization continued to rise. The dropoff in
activity, however, appeared to be less sharp than in previous surveys. Producers of high-tech equipment were the hardest hit, with sizable layoffs occurring at several firms. In contrast, there were reports that food processing plants enjoyed slight growth in sales for the month. Lead times were down slightly across most industries, with virtually no reports of material availability problems. Cutbacks in production in recent months have helped to reduce inventories, and most plant managers reported they were satisfied with current stocks.

Real Estate and Construction. Real estate and construction activity declined in the district in July. Housing starts dropped in most areas but remained largely unchanged from a year ago. Builders expect a further decline in activity in coming months. Sales of new and existing homes were stable in the district as a whole, but inventories of unsold homes were up considerably from a year ago in many cities. Mortgage demand was flat in July but still well above year-ago levels in most places, due largely to increased refinancing activity this year. Mortgage lenders generally expect a weakening in demand this fall, as refinancing begins to taper off. Commercial construction activity weakened in July and was below year-ago levels in most parts of the district. Office absorption was also down considerably. Vacancy rates increased in most cities, reaching record levels in some submarkets hit hard by dot-com failures and high-tech layoffs. There were also reports of overbuilding of retail space and multi-family units in several markets.

Banking. Bankers report that loans edged up and deposits held steady since the last survey, boosting loan-deposit ratios somewhat. Demand increased modestly for all loan categories except consumer loans and construction loans, both of which declined slightly. On the deposit side, increases in NOW accounts and MMDAs were offset by a decline in large CDs and small time deposits. Some respondents attributed these offsetting deposits shifts to the
narrowing spread between CD rates and rates on liquid deposit accounts. Others suggested that nervousness about the stock market could be boosting investors’ demand for liquid assets. Almost all respondent banks reduced their prime lending rates, and most also decreased their consumer lending rates. None of the respondents expected to adjust these lending rates further in the near term. Lending standards were unchanged.

**Energy.** Energy activity in the district continued to expand in July. Despite recent drops in oil and natural gas prices, the regional count of active drilling rigs was near a 15-year high. Several energy industry contacts expect oil and gas activity to back off their peaks in coming months. Others report that interest in gas exploration remains high and drilling activity would be even higher were it not for the shortage of rig workers.

**Agriculture.** District winter wheat producers harvested fewer acres and a smaller crop this year, but yields in many areas were better than previously expected. The district corn and soybean crops were generally in good condition, and yield prospects were favorable. Pasture conditions in some areas deteriorated in recent weeks due to dry weather, reducing forage supplies and discouraging ranchers from expanding their herds. Although livestock prices are relatively strong, district bankers expect low crop prices and high fuel and fertilizer costs to hold down farm incomes this year. As a result, bankers are keeping a close watch on their farm loans. Small business activity remained sluggish in most rural parts of the district.

**Wages and Prices.** District labor markets remained similar to the previous survey, with employers having a much easier time hiring most kinds of workers than earlier in the year. Many laid-off high-tech workers were having a difficult time finding jobs. An exception, according to one source, was webmasters. Worker shortages persisted for nurses, school teachers, oil field workers, and most construction trades. Wage pressures continued to be
virtually nonexistent outside of these fields. There were reports that some businesses were looking for ways to scale back benefits, such as free parking and health club memberships, that are no longer necessary to attract and retain workers. Retail prices were steady to slightly down in July, as many stores were trying to reduce inventories. These prices are expected to remain largely unchanged in coming months. Prices for some manufacturing materials edged lower due mainly to declines in energy prices. Purchasing managers generally expect flat prices in coming months. Some builders reported increases in lumber costs, which are expected to continue through the fall.
ELEVENTH DISTRICT—DALLAS

Eleventh District economic activity weakened further since the last beige book. Many manufacturers reported sales declines. Construction and real estate activity also declined, and the demand for business services was softer. Banking activity slowed, and energy activity was weaker. Retail sales were flat or up slightly. Most contacts do not expect much improvement in economic conditions through the end of the year. Hot, dry weather has hurt crop and livestock conditions.

Prices and Labor Markets. There were many reports of price declines. Energy prices have fallen and are likely to fall further. Both oil and natural gas prices were lower over the past two months. Natural gas inventories have built at unprecedented rates and are on pace to fill before the end of the summer. If so, prices could fall a lot further, according to contacts. Wholesale gasoline prices have fallen 40 percent since late May. National retail gasoline prices are also lower. Fuel and energy costs remain a concern for companies, but to a lesser extent than earlier in the year. Prices have dropped for petrochemicals, including some basic chemicals, such as ethylene and propylene. Prices have also fallen for plastic resins, such as polyethylene, polystyrene, polypropylene and polyvinyl chloride. Airlines are offering major discounts on summer airfares. Business service firms say fees are unchanged or lower than earlier in the year.

Layoffs in several industries have loosened the labor markets. Temporary service firms continue to see a greater number of skilled workers seeking employment. Wage pressures have subsided, but high health insurance costs remain a concern for many firms. Several contacts also expressed concern that stiff competition was containing price increases from their suppliers that could break loose if the competition subsides.

Manufacturing. Manufacturing activity weakened in June and July. Lumber sales continued to decelerate, with a particular drop in demand from retail stores that sell primarily to consumers. Contacts say lumber prices are “rock bottom” low. One contact had closed a plant while another has recently laid off employees. Lumber inventories are in good shape. The paper industry reports a drop in demand and sales have fallen by 10 percent to 30 percent compared to a year ago. Inventories, however, remain in good shape. Demand for food products was unchanged. Apparel producers say demand has been soft.

Fabricated metals producers said sales were strong to the energy industry but had dropped off for non-energy related uses in recent weeks. Demand for primary metals picked up in June, but contacts reported weaker sales in July, with one contact saying “[sales] just evaporated in July.” Demand for cement and concrete slowed since the last beige book, which contacts attribute to hot weather rather than an overall cooling of the market. Demand for brick and glass has been strong in recent weeks. Sales of
glass to the construction industry have been strong but glass sales have weakened to the auto industry. A contact reports that the glass industry has “too many suppliers right now.”

Respondents in the high-tech manufacturing sector reported that orders are less negative and appear to be flattening out. Excess capacity remains high and prices continue to decline. Most respondents said they had paired down inventories and current inventory levels are generally healthy. One respondent in the semiconductor industry noted that computers and telecommunications equipment account for about 60 percent of U.S. semiconductor production. He commented that while auto and industrial demand has improved, U.S. semiconductor production will not get much of a boost until there is improvement in computers and telecommunications. Respondents expect orders to remain relatively flat for the next several months and are hopeful they will begin to grow near year-end.

The telecommunications industry continues to contract, with weak sales and large losses. Contacts say there is a lot of pressure to do projects that will make money, but there is no money to spend on the projects, making it “virtually impossible to make any real head way.” Both service and equipment companies have taken aggressive measures to get inventories in line, often taking a loss and selling at huge discounts. Previously announced layoffs continue to be carried out while new layoffs are being announced.

Refining margins were strong until the end of June, and then the bottom fell out of the market. Inventories of refined products have reached levels well above their five-year average. Modest demand combined with high levels of domestic production and imports all combined to push inventories up. Several companies announced they are curtailing output to try to stem the glut.

The petrochemical industry continues to struggle with weak demand and rising capacity. One contact said the second quarter was the worst quarter since 1981, with several small producers filing for bankruptcy. Domestic demand remains weak, while foreign demand has fallen—especially from Asia. U.S. exports for the first half of 2001 were down 70 percent over the first half of 2000. Operating rates are 10 percent to 15 percent under normal conditions for most segments of the industry, and operating rates are in the low 60s for heavy natural gas users, such as ammonia or methanol. The outlook for the industry is grim, with new capacity coming on line as several large new plants are being completed for base petrochemicals.

Services. Demand for business services remains soft, particularly for temporary service firms. Temp firms reported fewer orders from all types of firms, with the largest drop from manufacturing. Law firms, however, say that conditions have improved despite the weak economy. While real estate and corporate activity has been slow, activity to support the energy industry and electric utility deregulation has helped keep firms busy, along with increased bankruptcies and litigation. Accounting firms report activity is slower but still busy, aided by the energy sector. Demand for transportation services has also
softened, particularly for airlines, where year-over-year revenues have "fallen off a cliff." Trucking firms say demand has been soft, partly due to the slowdown in high-tech oriented commercial business. Most service contacts were less optimistic about the outlook for activity for the rest of the year, expecting little or no growth in sales, with the exception of bankruptcy lawyers.

**Retail Sales.** Retail sales were flat or up slightly according to contacts. National retailers reported that Texas sales were not as strong as the rest of the nation. Several retailers noted that consumers are hunting for bargains, and there are not a lot of purchases at full price. One retailer said spending was up as a result of tax rebate checks, which consumers were using to purchase mostly discretionary items, such as electronics. Auto sales continued to pick up from a slow first quarter, and dealers reported stronger sales in June than a year ago. Contacts attributed the sales strength to large incentives and advertising. Auto inventories are in good shape.

**Financial Services.** Deposit growth continues to slow, and lenders say this has dampened their ability to lend somewhat. Delinquencies and non-performing loans are up, and loan loss reserve accounts have been built up at most banks recently. Although all institutions are seeing slowdowns in all categories, institutions that do business with energy-related companies are the strongest. The Houston area is faring the best, while contacts in the Austin area reports the most negative comments. Medium and small-sized institutions are doing better than larger institutions. Contacts are less confident about the outlook than during the last survey.

**Construction and Real Estate.** Construction and real estate activity declined in high-tech regions of the state. Residential and non-residential markets have continued to soften, dramatically in some areas. Sales of homes priced above $200,000 have been particularly slow, and some contacts say the market for these homes is overbuilt. Many $1 million homes are sitting on the market. Some contacts reported as much as a 20 percent to 30 percent sales decline from the beginning of the year. Activity remained steady to "brisk" for homes priced below $150,000. Homebuilders are offering incentive bonuses to realtors who sell homes.

The office markets softened considerably, with a lot of subletting pushing up vacancies. The North Dallas and Austin markets, which have heavy concentrations of high-technology firms, are reported to be the weakest areas, and several contacts expressed concerns about overbuilding in these markets. Office building owners are offering concessions—as much as 3 months free rent—to avoid reducing rental rates.

Dallas and Houston apartment markets appear to be in good shape. Apartment rent concessions are almost gone in Dallas, according to contacts. In Austin, however, rents are expected to decline this year. Contacts consider the Austin market to be very overbuilt. One contact said, "it will take a year to reach the bottom and several to dig out."
Energy. Energy activity was weaker. Contacts say firms are reassessing investments, particularly in light of falling natural gas prices. Many producers spent ahead of budget and cash flow in the first half of the year and are now pausing to get back on budget. As a result, demand for rigs has weakened. Utilization rates for rigs are down to 85-90 percent, and rates for rigs are down 10-15 percent. The growing consensus is that domestic drilling activity has probably peaked for now.

Agriculture. With mostly dry weather and temperatures over 100 degrees, crops are rapidly losing potential yield and quality. The Texas cotton crop may be close to last year’s drought-reduced level. Drought has cut the crop for three of the last four years. The resulting economic stress leaves few viable crop production alternatives for producers and lenders. Herd reduction increased in drier areas, and supplemental feeding of livestock spread as available pasture grasses continued to decline.
TWELFTH DISTRICT – SAN FRANCISCO

Summary

Twelfth District contacts reported continued slowing in economic growth and reduced pressures on non-energy related prices and wages in most sectors in the June to late-July period. The cost of energy at the retail level increased on balance, as higher electricity rates were only partially offset by lower rates on natural gas. Respondents indicated that conservation was the most common action taken to offset higher electricity prices; though there were isolated reports of curtailments in production. District retailers experienced weak sales and many offered price discounts. Manufacturers reported further deterioration in sales and continued contraction in employment. With few exceptions, respondents indicated that investment in high-tech equipment and software remained depressed. Respondents also noted that conditions softened in commercial real estate markets, while single-family housing markets remained more stable. District agricultural producers continued to struggle against low prices, weak exports, higher energy costs, and the weather. District financial institutions reported further tightening of lending standards and weaker demand for credit.

Wages and Prices

Twelfth District contacts reported evidence of reduced pressures on prices in several sectors, with a notable exception being retail electricity rates, and on wages in the June through late-July period. Further increases in retail electricity rates put additional pressure on businesses and consumers, though forced outages were limited. In addition to lower natural gas and gasoline prices, respondents noted lower prices for a range of non-energy producer inputs, including lumber and other construction materials. Lower airline fares, advertising fees, and rental rates also were reported. Retailers and manufacturers offered discounts to promote sales.
In contrast, prices for prescription drugs have increased substantially. In labor markets, with a few exceptions, contacts indicated that slower economic growth was responsible for an easing of pressures on wages.

Twelfth District businesses continued to adjust to the high cost of electricity during the June to late-July period. Respondents frequently cited aggressive conservation efforts to reduce usage and costs. Some respondents also have added backup power systems and a few have changed production schedules. Some power suppliers have been buying power back from farmers and large industrial users, which in turn have reduced their operations. Some hotels and construction firms reported passing along higher energy costs to consumers, while other contacts, especially those in agriculture, reported that they were absorbing the higher costs.

Retail Trade and Services

Twelfth District retailers recorded generally weak sales in the period from June through late-July. Retailers noted that discounts were common and larger than normal for the early summer season. Contacts reported that sales were running behind forecasts and comparable store sales were lower than last year. However, contacts from the Intermountain region reported that new car and light truck sales rose in June and dealers were working down inventories.

Service sector jobs in the District remain at close to December 2000 levels. Contacts reported cutbacks in jobs in the high-tech services and advertising sectors. Respondents from Hawaii noted that the travel and tourism services sectors have slowed, and the most recent published data show May hotel occupancy rates were below year-earlier rates.

Manufacturing

Twelfth District manufacturing conditions remained weak and employment continued to contract. Contacts reported weak sales of non-durable goods—such as apparel, sporting goods,
and paints and coatings—as well as durable goods—such as computers and communications gear. Third quarter semiconductor sales are expected to fall below second quarter sales; however, new orders have picked up somewhat, and progress was made in reducing inventories during the first half of this year. Excess capacity was reported for semiconductor manufacturers and telecommunications, including broadband networks. New orders for commercial aircraft remain weak, reflecting sluggish passenger traffic growth in 2001 and weak earnings among airlines.

With few exceptions, District contacts reported that the level of investment spending on computers, information-processing technology, and software remained below spending on such items a year earlier. Respondents attributed the reduction to high levels of high-tech investment in 2000 and a general cutback in investment in response to uncertainty about the outlook for the economy and efforts to reduce costs. While contacts indicated that the pace of investment spending had not deteriorated in the June through late-July period compared to the previous survey period, neither did they report signs of an upturn.

Agriculture and Resource-related Industries

Twelfth District agriculture has continued to struggle. Favorable domestic farm production levels were offset by depressed world market prices and a strong dollar that limited export sales. High electricity costs and water shortages in several states put further pressure on the farm sector. District ranchers continue to benefit from steady cattle prices, but may face higher costs and lower yields as a result of drought-like conditions. Respondents indicate that lumber mills in the Pacific Northwest have cut back production, partly in response to import competition and lower lumber prices.
Real Estate and Construction

Respondents noted that conditions softened in a number of commercial office markets. Office vacancies jumped up in second quarter in several metropolitan areas in the District, and reportedly continued to rise in July. Contacts noted a sharp decline in the demand for office space in the California markets of San Francisco and the Silicon Valley during the period. The rise in office vacancies in those markets was attributed to the Bay Area’s economic slowdown, especially in the high-tech sectors, that has led to a sharp increase in availability of sublease space. Respondents also indicated that expectations of potential tenants that lease rates will fall further might be damping leasing activity. In Oregon, new construction and leasing activity were slower than expected. In addition, increased sublease space and new speculative office building have pushed up office vacancy rates further in Utah.

In the residential sector, respondents indicated that single-family housing markets remain stable in most of the District. Single-family markets reportedly were boosted in part by relatively low mortgage rates. There are signs, however, of a slowdown in home sales in the high-end market in the San Francisco Bay Area. Declines in rental rates in some markets also could affect multi-family construction activity.

Financial Institutions

Twelfth District financial institutions reported that credit conditions continued to tighten during the June to late-July period. California lenders noted they were experiencing slower growth in loans and deposits. Slower loan growth was attributed to tighter lending standards, including for new customers and small businesses, and weaker demand for credit. Overall, respondents note that bank balance sheets remained healthy and earnings were good.