

**For use at 2:00 p.m., E.S.T.
Wednesday
November 28, 2001**

Summary of Commentary on

Current Economic Conditions

by Federal Reserve District

November 2001

SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICTS

NOVEMBER 2001

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SUMMARY¹

Reports from the Federal Reserve districts indicate that economic activity generally remained soft in October and the first half of November, with evidence of additional slowing in most regions outweighing signs of recovery in a few districts. Manufacturing activity weakened further, with declines in production, new orders and employment widely reported. Consumer spending was mixed—aggressive financing incentives drove automobile and light truck sales to exceptional levels, but tourism remained weak and nonauto sales were spotty, with stronger sales growth in some areas offset by weaker sales elsewhere. Retailers' outlook for spending during the upcoming holiday season was also mixed. Store managers had already begun discounting prices in some areas to counteract weak customer traffic, while in other areas retailers' expectations for the season had brightened recently. Residential real estate generally held its own, with sales of moderately-priced homes steady and permits for new construction increasing modestly in all but a few regions. In contrast, the demand for commercial space eased further, pushing vacancy rates higher and rents lower in many areas. In the finance sector, the pace of residential mortgage refinancing activity accelerated as mortgage interest rates fell further. Business lending weakened though, reflecting softer loan demand and some tightening of lending standards. Labor markets continued to ease. Layoffs and downsizings contributed to a greater supply of available workers and wages were steady to lower. Prices were generally stable, although lower prices were in evidence for automobiles, gasoline, and computers. In contrast, prices for insurance and health care rose sharply.

Consumer Spending: Consumer spending, while strengthening slightly in October and the first half of November, remained at or below pre-September 11 levels in most districts. Most Reserve Banks reported that sales of luxury goods weakened, as did sales at specialty and department stores. In contrast, discount retailers generally experienced stronger sales as consumers sought value. Store managers had mixed expectations about sales prospects for the upcoming holiday season. Retailers in

¹ Prepared at the Federal Reserve Bank of Richmond and based on information collected before November 19, 2001. This document summarizes comments received from business and other contacts outside the Federal Reserve and is not a commentary on the views of Federal Reserve officials.

Philadelphia and San Francisco expected lower holiday sales, as did managers at upscale stores in the Atlanta district. In contrast, retailers anticipated higher sales in Cleveland, Richmond, St. Louis and Kansas City. Inventories at retail establishments were described as too high in Boston, New York and Atlanta, but St. Louis said their contacts were evenly split between those with inventories at desired levels and those with excess inventories. Automobile sales surged, spurred by attractive dealer financing incentives. Dealers in most districts reported strong sales in October but in November sales slowed in Atlanta, Chicago, Minneapolis and Dallas. Looking ahead, automobile dealers expressed concern that sales in coming months would fall as incentives ended.

Two districts had upbeat reports on tourism while others continued to feel the effects of September 11 and the slowing economy. New York reported that occupancy rates in Manhattan, which plunged below 50 percent in late September, rebounded to about 75 percent in October—12 percentage points below a year earlier. In addition, some Manhattan hotel rooms were being used as interim office space by firms displaced by the September 11 terrorist attacks. In the Richmond district, a contact attributed solid holiday bookings to tourists staying closer to home because of concerns with airline safety. Atlanta, St. Louis and Minneapolis reported that the hospitality and tourism sectors continued to suffer from the slowing economy and the impact on air travel of the terrorist attacks. Atlanta noted that a major car rental firm in Florida filed for Chapter 11 bankruptcy because of a sharp decline in activity and that the opening of a large hotel in Orlando had been postponed as attendance at local tourist attractions waned.

Manufacturing: Manufacturing activity weakened further in nearly all regions in late October and the first half of November. More than two-thirds of the districts reported that new orders and production decreased or grew more slowly. On balance, capital expenditure plans remained weak, but contacts in several districts reported that the general attitude of firms was to hold the line rather than to cut capital spending further. Businesses continued to draw down their inventories with most districts suggesting that the bulk of reductions was behind them.

Five of the districts indicated that conditions in telecommunications and other high-tech equipment manufacturing industries softened further during the survey period. Other sectors experiencing declining shipments and orders included: construction-related

manufacturers in Dallas; heavy equipment producers, including trucks, in Chicago; building products industries in Atlanta, Dallas and San Francisco; and furniture and apparel manufacturers in Richmond. In contrast, firms producing food products in Philadelphia, Kansas City and Dallas noted stronger-than-expected demand for their products. However, Boston and Philadelphia reported that their contacts did not expect business activity to improve until the second half of 2002.

Construction and Real Estate: Residential real estate activity displayed little change in most districts. Cleveland reported an improvement in home sales activity, while Richmond, Chicago and Dallas indicated slower sales. In the Boston, New York and Kansas City districts, sales activity was weaker for higher-priced homes. Philadelphia and St. Louis reported that sales activity was mixed. In the Chicago district, builders' expectations of future construction activity was mixed—some builders were concerned that inventory was too low while other builders sought to withdraw from signed purchase contracts for home sites. Residential building permits increased in the New York, Philadelphia, St. Louis, Minneapolis, Kansas City and Dallas districts, while the San Francisco Reserve Bank reported that permits declined in the San Francisco area but remained strong in southern California. Declining mortgage rates made lower priced homes more affordable for first-time homebuyers but did little to boost sales of homes in upper price ranges, resulting in a surplus of higher-priced homes for sale in the Richmond and St. Louis districts. Residential construction remained stable in St. Louis, Minneapolis and Kansas City and declined in Chicago and San Francisco.

Leasing activity in the commercial real estate sector weakened further across all reporting districts. Increasing vacancy rates and softening rental rates were widely reported, except in the Philadelphia district, where rental rates remained relatively stable but were expected to decline. Commercial construction was flat in most districts, although Cleveland and Richmond reported a modest number of projects underway or planned for the near future.

Banking and Finance: Lending activity was mixed in most districts, as stronger demand for residential mortgage refinancing was offset by weaker demand for commercial loans. New York, Cleveland, Richmond, and San Francisco reported higher demand for residential mortgage loans. Atlanta and Chicago said that mortgage

refinancing was “brisk” and at “record levels,” respectively. Demand for commercial or business loans was said to be stable in New York, but “soft” in Cleveland, Atlanta, and Chicago, “slipping” in Richmond, and “declining markedly” in San Francisco.

Philadelphia said that consumer, commercial, and real estate lending all declined, while Kansas City reported that demand fell for all loan categories except home mortgages.

Several districts reported tighter credit standards for bank lending and increases in loan delinquencies. New York said that with the exception of residential mortgages, credit standards for all types of loans tightened further while Atlanta reported some tightening of credit standards for loans secured by commercial real estate. Cleveland and Chicago reported declines in credit quality and increases in loan delinquencies.

Philadelphia indicated that banks were becoming more concerned about credit quality because a growing number of business borrowers had fallen short of revenue goals.

Labor Markets, Wages, and Prices: Labor markets continued to ease in most districts. Extremely weak labor market conditions were reported by a major employment agency in the New York district. Employment in New York City was reported to have fallen by more than 70,000 in October. Boston reported widespread weakness in the temporary employment industry; industry revenues were 30 to 40 percent lower than a year ago. Cleveland and Richmond also reported weak or slowing demand for temporary workers. In Cleveland, some industries were trimming employment as a result of the after effects of September’s terrorist attacks while layoffs continued in Minneapolis and Dallas.

In Boston, temporary employment agencies reported that clients were increasingly seeking reductions in billing rates for temporary workers, but profit margins were being maintained and wages were holding steady. Wages were slightly lower at small firms and generally flat at larger firms in the New York district. In Cleveland wage pressures eased, reportedly because workers were more uncertain about job security.

Upward price pressures were subdued across all reporting districts. The majority of the districts reported manufacturing input prices as flat to lower. Most districts noted that prices for retail goods were steady to slightly down, but Atlanta experienced some occurrences of “deep discounting.” Most districts noted a dramatic increase in costs for property insurance and/or healthcare related products and services.

Agriculture and Natural Resources: A dry autumn reduced agricultural production in some regions, and low commodity prices affected both agricultural and energy producers. Arid conditions in Richmond, Kansas City and Dallas depleted topsoil moisture, causing poor germination of small grain crops in those areas. Respondents in these districts also reported that range and pasture conditions deteriorated as dry weather persisted, increasing the need for supplemental feeding of livestock. Kansas City noted that dry conditions limited forage supplies in some areas of the district, encouraging ranchers to liquidate herds despite weak prices this fall. In contrast, the St. Louis district received heavy rain at times, which delayed the planting of the wheat crop, but replenished soil moisture.

Credit quality deteriorated as low prices for agricultural products and cattle prevailed in a number of districts. Lenders in the Minneapolis district reported a 10 percent drop in cattle prices over the past month, adversely affecting many of their customers' ability to repay loans. Atlanta and San Francisco indicated that a decline in world demand for textile products and high levels of domestic production has led to some of the lowest cotton prices in the past 25 years.

Activity in the energy and mining sectors was down. In the Minneapolis district, oil and natural gas exploration and production were below the levels of early October. Contacts in the Dallas district said that energy activity has gone from overheated to very cool in a short period of time. Prices for oil services and rigs have softened as a result of weaker demand, although strong pockets of domestic activity and high levels of activity in international markets are propping up revenues and profitability. A large northern iron ore mine in Minnesota reduced production starting in mid-October because of weak orders from steel producers and a platinum mine in Montana decreased output.

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FIRST DISTRICT – BOSTON

Although retailers report some rebound from September lows, most business contacts in the First District report sales or revenue in October and early November below year-earlier levels. Many have cut or are cutting jobs. Capital spending is said to have steadied at a low level. Most respondents express great uncertainty about the timing of the recovery.

Retail

Most retail contacts say sales bounced back partially in October and early November after steep September declines, but overall sales for the September through early November period were below year-earlier levels and below expectations. Sales of surplus merchandise, an “inverse barometer” of the economy, boomed during the same period.

Employment levels are reported to be either flat or declining as wage rates continue to rise at a 3 to 4 percent pace. Most retail contacts say they are holding prices steady and their profit margins are steady as a result. By exception, computers and footwear are being heavily discounted in order to move inventories. Some vendors are said to be reducing prices.

Retailers’ expectations have adapted to current conditions. Only those selling construction supplies and home furnishings expect sales to improve in the near term. Most expect flat to negative results through next summer, with a turnaround in the economy in the third or fourth quarter of 2002.

Manufacturing and Related Services

First District manufacturing contacts report that third-quarter and early fourth-quarter revenues are largely down from a year ago. The few firms whose sales are flat or rising slightly describe their results as subpar and say they are under pressure to discount their products in order to maintain or increase their market share. The sharpest sales declines are reported by companies selling equipment and supplies to the semiconductor, telecommunications, and aerospace/airline industries.

Many manufacturers note that their receivables are rising or that customers appear to be having cash flow problems. Concerns are especially pronounced among contacts selling to retailers (with the notable exception of Wal-Mart). Most manufacturers are still reducing their inventories. However, many

say that most of the reductions are behind them or that this will be the case by year-end.

Contacts report that selling prices are flat or under downward pressure. Materials costs are largely flat and energy costs have fallen. However, quotes for property and casualty insurance are “going through the roof.”

Many manufacturers reduced employment during 2001, some as recently as September and October. Most are now waiting to see whether these measures are adequate to contain costs, although a few plan furloughs around the upcoming holidays or are still implementing scheduled head count reductions. Similarly, the general stance with respect to capital spending is to “hold the line” rather than cutting further. Manufacturers frequently mention that they have frozen wages and salaries or are granting only minimal increases. Several point to a need to contain fringe benefit expenses, especially in light of rising health insurance costs.

Preliminary forecasts for 2002 are uncertain but mostly assume that revenues will be similar to 2001 levels. Most contacts expect that the first half of the year will be tough, with a recovery taking hold in the second half.

Temporary Employment

The temporary employment industry continues to weaken. Overall revenues are reported to have dropped 30 to 40 percent from a year ago. Client companies are increasing pressure to reduce billing rates, but profit margins are holding; nevertheless, profits have fallen with volume. The weakness is widespread, with contacts supplying technical and IT workers hit the hardest, but respondents report some growth in demand for workers in customer service, pharmaceuticals, bio-sciences, mortgage and banking, securities, and non profit organizations. This quarter, traditionally busy because of the holidays, shows no surge in business to date. On the supply side, the market is overflowing with inquiries from job seekers. Client companies are interviewing more candidates and taking longer to fill positions. Wages are generally holding steady. Contacts expect that the current quarter and the first quarter of 2002 will be soft. Many predict a rebound in the second or third quarter of 2002.

Commercial Real Estate

Commercial real estate markets in New England have deteriorated significantly during the past few months. Boston area contacts report double-digit vacancy rates, with most of the newly vacant space subleased by tenants who do not need space they had committed to pay for. Besides low demand, developers say it is difficult to insure new buildings following the terrorist attacks. While available inventory is rising, rental rates have been declining. In Boston, the decline in rents has been modest so far, but in the suburbs, rates are reported to have halved. The rest of New England is experiencing milder weakening, albeit from much lower peaks. A Rhode Island contact reports “a bit of a downturn,” with basically flat vacancy and rental rates. Most contacts expect the market to remain weak for quite some time, noting that real estate is typically last to recover from a recession.

Software and Information Technology Services

According to most respondents, demand for software products has returned to expected levels in October after falling off in September; overall, demand is “flat to up slightly.” Some report that potential customers are still too “distracted” by September’s events to move forward on planned software upgrades. Contacts that are doing well offer a range of explanations, including their competitors going out of business, improving “sentiment” toward technology, and introduction of a new product.

All are uneasy about the future. While most believe that the national economy has “bottomed out,” none will venture a guess as to when the recovery will begin. One respondent said that uncertainty prevented the company from writing a business plan more than two quarters into the future. Generally, respondents reported that they are planning on keeping employment level. Capital spending also continues to be only by necessity, with a few exceptions. One company is in the process of acquiring competitors, distribution outlets, and some additional application providers whose capabilities they want to add to their software. Another firm will upgrade its internal software because a supplier offered an 80 percent discount and 180-day payment schedule. Both say these moves position them for the recovery.

SECOND DISTRICT--NEW YORK

The Second District's economy has shown signs of rebounding from the depressed levels of the last report. Despite the apparent pickup in economic activity, labor markets have continued to show signs of deteriorating. Department stores report that sales have improved steadily since the last report, though they remain below plan. While prices appear steady to somewhat lower, businesses report widespread increases in insurance costs.

Housing markets in and around New York City have rebounded as of mid-November, though Manhattan's rental market remains soft. Manhattan's office market continued to ease in October, as a sizable amount of space has come onto the market. Hotel occupancy rates rebounded considerably in October, though they are still about 10 to 15 points lower than a year ago. Purchasing managers report substantial weakening in business conditions in the New York City area, but only modest declines in upstate New York; they also indicate steady to declining input prices. Finally, bankers report weaker demand for consumer loans, stronger demand for home mortgages, further tightening in credit standards, and little change in delinquency rates, based on the latest survey, taken in early November.

Consumer Spending

Retailers generally report that sales were below plan in late October and early November, with year-to-year comparable store sales ranging from down 8 percent to up 4 percent. Discounters continued to out-perform department stores, but by a narrower margin than in the last report. Sales at Manhattan stores, which experienced the sharpest declines in the weeks following the attack, have rebounded briskly in October and early November, though they continue to under-perform.

A major discount chain notes increased traffic but lower sales per customer. One large department store chain reports particular weakness in luggage sales, but some pickup in home-related

merchandise, such as furniture, linens and kitchen-wear. In general, apparel sales have been sluggish, though the women's segment has done substantially better than men's wear.

Most contacts report that inventories are a bit high but in relatively good shape. However, markdowns are expected to be more pronounced this holiday season than last year. Selling prices and merchandise costs are reported to be running little changed to slightly lower than a year ago. While wages are little changed and energy costs are down noticeably, retail contacts report sizable increases in medical insurance costs and dramatic increases in property insurance premiums.

Separately, a survey of New York State residents conducted by Siena College in October shows a moderate rebound in consumer confidence in the New York City area, following steady declines from June to September. In upstate New York, confidence levels have been fairly steady since July but are substantially lower than a year ago.

Construction and Real Estate

Manhattan's office market continued to ease in October—availability rates edged down in Midtown Manhattan but rose slightly in Midtown South and rose sharply in Lower Manhattan. Part of Lower Manhattan's softening is due to several of the less seriously damaged buildings near Ground Zero coming back on-line. Also, ongoing transportation disruptions and sub-par air quality may be affecting demand, at least in the short run. A large majority of the displaced firms have reportedly relocated to Midtown Manhattan.

On the residential side, market conditions appear to have improved since the last report. Homebuilders in northern New Jersey indicate that demand for new homes has picked up since the last report. Traffic has improved markedly, though prospective buyers have become "more tenuous"—waiting longer to buy, making more repeat visits, and ordering fewer upgrades and amenities. Prices have held steady, though the reduction in upgrades is expected to reduce the reported average price.

Labor and materials are no longer in short supply, as had been the case earlier in the year.

In Manhattan, a major real estate appraisal firm reports that co-op and condo sales volume has rebounded slowly but steadily in recent weeks, though it is still lower than a year ago. Separately, a leading New York City real estate firm reports that apartment sales activity has picked up substantially in the first half of November, following a slump in late September and October, while the number of listings has increased only moderately. For the most part, there is lively bidding on units whose asking prices have been reduced by 5 to 10 percent. Both contacts indicate that the high end of the market has weakened the most, while reduced mortgage rates have reportedly helped the market for small apartments. Geographically, prices in Chelsea, Soho, and Tribeca are said to be down about 10 percent, on average, but selling prices in uptown Manhattan appear to be down only a few percent.

Other Business Activity

New York City employment plunged by more than 70,000 in October, while New Jersey's job count rose by 11,000. The New York number was depressed, and New Jersey's boosted, by the—in many cases quite temporary—displacement of Wall Street jobs across the Hudson. A major New York City employment agency, specializing in mid-level office jobs, reports extremely weak labor market conditions; the only notable hiring activity is coming from law firms, while financial and business service firms are hiring only very selectively. More generally, while small firms are said to be offering slightly lower salaries than earlier in the year, compensation at larger firms is generally flat.

Tourism to New York City appears to have rebounded since the last report. Manhattan hotels report that occupancy rates, which plunged below 50 percent in late September, rebounded to about 75 percent in October—only 12 points lower than a year earlier. Some firms displaced temporarily by the terrorist attack have been using Manhattan hotels as interim office space. Hotels have reportedly reduced their room rates by 25 percent, on average, since the attack, with some establishments in Lower

Manhattan making reductions of up to 40 percent. Hotels in northern New Jersey report occupancy rates close to 70 percent in October—also down about 10 to 15 points from a year ago—and similar trends are reported in Long Island.

Purchasing managers report substantial weakening in business conditions in the New York City area, with a sharp deterioration in both the manufacturing and non-manufacturing sectors between early-September and early-October. Widespread price declines were reported, especially for manufacturing inputs. The picture in upstate New York appears less dire: Buffalo-area purchasers note some further weakening in business conditions in October—employment declines were fairly widespread, but trends in production activity and new orders were mixed. Rochester-area purchasing managers report continued weakness in general business conditions, but to a lesser extent than in September; input prices are reported to be flat to lower.

Financial Developments

According to the latest survey of small to medium-sized Second District banks, conducted in November, demand for loans has been mixed since the last report. While demand for consumer loans decreased fairly substantially, on balance, widespread increases were reported for residential mortgages, as well as refinancing activity. Demand for nonresidential mortgages and for commercial and industrial loans remained stable.

On the supply side, credit standards tightened further for all types of loans, except for residential mortgages, which remained stable. No bankers report easing of standards for any types of loans. Widespread declines were reported in both loan rates and deposit rates. Delinquency rates were reported to be little changed for all types of lending.

THIRD DISTRICT – PHILADELPHIA

Business conditions in the Third District remained soft in November.

Manufacturers reported continuing declines in shipments and orders. Retail sales of general merchandise have been improving slowly week by week, but are still below year-ago levels. However, auto sales have been running at a very high rate, boosted by manufacturers' incentive financing. Bank loan volumes have declined in the major credit categories: business, consumer, and real estate. Commercial real estate markets have eased. Home sales rose during October and November, but appear to be off from the same months last year. Firms in a variety of industries in the region have announced layoffs and hiring freezes, but the pace of job cuts does not appear to be accelerating.

The outlook in the Third District business community is generally subdued.

Manufacturers predict an upturn by the middle of next year, but in other sectors forecasts are less optimistic. Retailers expect sales for the holiday shopping period this year to be below last year's level, and they are concerned that sales might remain weak into the spring of next year. Auto dealers expect a large drop in sales in the first quarter of next year, as consumer demand ebbs and manufacturers' zero-interest rate financing ends. Bank credit officers expect commercial and industrial lending and consumer credit demand to remain soft, and they expect a drop in real estate lending. Contacts in the real estate industry forecast easing rents and rising vacancy rates in commercial markets and some falloff in the rate of home sales. The general opinion is that the decline in real estate and construction activity will be modest.

MANUFACTURING

Third District manufacturers continued to report decreases in activity in November, with little change in the rate of decline. Orders and shipments were down compared with October in nearly all the major manufacturing sectors in the region, although some firms producing electrical equipment and food products reported increases in orders. A majority of the region's manufacturers maintained steady employment and working hours in November compared with October, although around one-third made cuts, and only a few firms expanded employment or hours. Area firms continued to

reduce inventories, on balance, although some firms indicated that inventory reductions have brought stocks down to desired levels. Around one in five firms said they will maintain lower than usual inventory levels because they anticipate a slow recovery in demand for their products. The region's manufacturers generally reported further softening in prices for both inputs and the goods they manufacture, although firms in the food products and electrical equipment sectors have increased prices for their products as demand has picked up.

Local manufacturers have slightly trimmed their forecasts lately. Just over half of the firms surveyed in November forecast increases in orders and shipments during the next six months, but some firms that had previously anticipated a relatively quick upturn now expect business to be flat through most of the first half of next year. On balance, area firms have cut back capital spending plans, but they do not plan to reduce employment from current levels.

RETAIL

Third District retailers reported gradual weekly improvement in sales in October and November, but most indicated that the recent sales pace remains below the rate set in October and November of last year. Discount stores posted moderate year-over-year gains, but sales at department and specialty stores were down. Merchants said shoppers are mainly buying necessary goods and staples. Sales of luxury goods have been especially slow at all types of stores. Some merchants also noted that credit sales have slipped relative to cash sales. Store officials said they are fully stocked for the holiday shopping period, but may trim orders for spring merchandise.

Area retailers expect sales for this year's holiday season to be below last year's. They expect extensive promotions and marketing efforts will be required to make their sales goals, and they are concerned that profits will suffer as a result. Retailers suggested that sales in December and January will be crucial to their plans for the spring. If holiday sales are significantly below current expectations, retailers will cut back orders for merchandise, advertising expenditures, and expansion plans.

Auto sales in the region have been very brisk, in response to manufacturers' zero-interest rate financing. Dealers expect sales to fall off sharply in the first quarter of next

year as consumer demand becomes sated and manufacturers' incentive-financing programs end. Dealers have been limiting their orders to manufacturers in anticipation of the drop in sales.

FINANCE

Lending at major Third District banks has been easing. Outstanding loan volume has declined in all major credit categories—commercial, consumer, and real estate. Bank lending officers said demand for business loans has been particularly slow. Some bankers noted that their business customers who have term loans have expressed interest in paying them off ahead of schedule. Several bankers said businesses are reluctant to expand now because economic conditions are uncertain or because they want to wait to take advantage of anticipated tax legislation favorable to capital investment. Concern about business credit quality has grown at banks in the region as a growing number of business borrowers have fallen short of their sales or revenue goals. Nevertheless, most of the bankers contacted for this report said they are still actively seeking to increase their commercial loans.

Bankers in the Third District expect business loan demand to remain soft until there are clear signs that business conditions are improving. They expect demand for new homes to fall, and some are limiting their lending to building contractors. Bankers expect consumer lending to expand slowly as retail sales regain some lost ground.

REAL ESTATE AND CONSTRUCTION

Third District commercial real estate markets have eased in the past few months. The vacancy rate for office buildings has risen by one to two percentage points in most market areas in the region. In the Philadelphia central business district, the vacancy rate has risen to around 13 percent, according to recent estimates by commercial real estate firms. In suburban markets, the rate has risen to an average of 14 percent. Vacancy rates have risen as new buildings have come on the market in the suburbs. Also, firms in the Philadelphia central business district and in the suburbs have reduced their use of space, making more space available for sublease. Rental rates have been relatively stable despite softening demand, but commercial real estate agents expect rents to begin

trending down throughout the region. Demand for industrial space has also eased. Although the industrial vacancy rate has been steady, many new buildings have become available recently, and real estate agents expect vacancy rates to begin moving up.

Residential real estate agents gave mixed reports. Sales to first-time homebuyers have been resilient, but sales of high-priced homes have eased. Some contacts in the real estate industry also noted a falloff in sales of homes and townhouses in senior citizen communities. Homebuilders reported that sales picked up in October after a sharp drop in September. The higher rate of sales appeared to be persisting in November, but not increasing. Builders have raised prices for homes in most price ranges except the very high end, where demand has eased. Real estate agents and builders indicated that relatively low mortgage interest rates have encouraged first-time homebuyers, and move-up buyers are looking more favorably on house purchases as investments. Real estate agents expect an easing in the sales rate, but not a sharp drop unless employment in the region falls more sharply.

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FOURTH DISTRICT - CLEVELAND

Reports gathered in early November suggest the Fourth District economy has bottomed out. None of the contacts surveyed expects economic conditions to worsen, and signs of recovery are beginning to emerge: Manufacturers reported some improvement in the level of new orders, steelmakers reported that prices have stabilized, retailers reported strong sales among discount chains and improved forecasts for holiday sales, bankers reported improvement in their net interest margins, residential builders reported business is near the same levels as last year, and commercial builders expect prospects to brighten with the new year. While business in December may remain sluggish, most industries expect conditions to improve markedly during the first half of 2002.

In the labor market, however, job security continues to be a serious concern. Some industries have suffered major losses in employment as a result of the economic downturn and the September 11 attacks. Other industries that were not able to shed jobs through layoffs and restructuring have stopped filling open positions to reduce labor costs. The demand for temporary workers has slowed considerably over the past few weeks. Wage pressures have eased, reportedly because workers are more uncertain about their jobs. Benefits costs are rising, with most contacts specifically identifying increasing health care costs. Skilled labor is easily available, and open positions are being filled with minimal recruiting efforts.

Manufacturing

Although several manufacturing indicators in the District continued to decline in October and early November, some improvement in new orders in the northern part of the District and a slowdown in the decline in new orders in the southern part of the District suggest that industry conditions may improve during the first quarter of 2002. Most manufacturing contacts reported that employees were working shorter weeks with no overtime.

Contacts in the steel industry noted that prices stabilized in October and November, but did so at very low levels. Most companies reported selling steel at or below cost, and contacts noted that companies operating under bankruptcy protection are pricing their products artificially low to keep their contracts, contributing to the downward price pressures in the industry. Steelmakers that produce niche products reported for the first time that business was sluggish, but noted that they do not expect this weakness to persist.

Retail Sales

Reports from area retailers were mixed: discount retailers reported that October sales figures were much stronger than last year's, while higher-end retailers, apparel retailers, and retailers located in malls reported very weak sales. Some contacts reported that year-over-year sales were down as much as 15 percent. Several contacts noted a continued shift in consumer preferences from more expensive, high-end products to lower-priced products.

Retailer forecasts for the holiday season have improved since the last report, reportedly due to positive consumer response to aggressive advertising, increased discounts, and special promotions. In our last report, retailers were generally pessimistic about the holiday season, but now most retailers are characterizing their outlook as "cautiously" or "guardedly" optimistic. Discount retailers have a more optimistic outlook, and expect above average-sales this year. Apparel retailers appear to be an exception to the increasing optimism in the District, with most still forecasting year-over-year sales to be down around 5 percent.

Automobile dealers reported that manufacturers' offers of zero-percent financing led to record sales in October, and initial reports for November suggest that, although sales have begun to slow, this month's sales figures will also be higher year-over-year. Strong sales during the last quarter of 2001 are expected to result in a significant drop in sales for first quarter 2002, but dealers expect sales to return to "normal" levels during second quarter 2002.

Construction

Commercial contractors reported that bidding for jobs has become more competitive over the last six weeks. Many firms are taking jobs they would not normally take in order to maintain current staffing levels through the winter months, as they anticipate needing their staff for projects in the spring. Contacts have seen an increase in the number of projects scheduled for the spring and less hesitation by customers to move forward on projects that had been in the planning stages or delayed.

Most homebuilders reported that sales improved in October and early November and levels were similar to those at this time last year. The current pace of sales, however, is still substantially slower than earlier in the year. Nevertheless, customer traffic continues to improve, causing most homebuilders to be "cautiously optimistic."

Trucking and Shipping

Trucking and shipping activity improved little in October, and there has been a decline in the volumes shipped for November, partly due to seasonality. Activity is significantly down

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year-over-year. The volume of steel and manufacturing-related goods carried remains depressed. Contacts noted that shipping of retail and auto-related goods did not increase as much as expected given the October sales gains for discount retail goods. This suggests that inventoried goods, rather than increased production, have accounted for a large share of recent retail sales.

The outlook offered by our contacts indicates that activity will remain weak at least through first quarter 2002. Both carriers and their customers have moved in recent weeks to protect their declining profit margins against increasing cost pressures. Customers continue to transfer freight hauling from air to ground. Carriers are curtailing capital expenditures, and some are phasing in slight rate increases. Although the industry is very competitive, these price increases have stuck because customers appear to be willing to pay a premium for reliable and financially stable carriers during a time when many trucking companies have gone, and continue to go, bankrupt.

Banking

Most banks reported improvement in their net interest margins due to the lower cost of borrowing, but a few contacts did report tightening net interest margins. Competition for borrowers remains aggressive across all lines of lending. Demand for commercial loans continues to be soft in the District, but consumer loan demand has been mixed. There has been some increase in mortgage lending, as consumers refinance to take advantage of lower interest rates, but there has been significant decrease in demand for auto loans as consumers are opting for zero-percent financing offered by manufacturers. On balance, the number of loan applications has remained steady. All contacts except one reported a slight decrease in credit quality, and most banks reported a slight increase in the rate of loan delinquencies over the last six weeks.

Travel and Tourism

Contacts believe tourism in the District has remained fairly insulated from the effects of September 11 because it does not rely heavily on air travel, but current levels are slightly lower than before September 11. Business travel, which had already been declining more than tourist travel prior to September 11, continues to drop. Most of the decline in business travel is attributed to cutbacks in business spending to address current economic conditions. Although some meetings and conventions were cancelled in the weeks following September 11, these cancellations were rather limited and did not persist.

FIFTH DISTRICT—RICHMOND

Overview: Fifth District economic activity edged lower in October and the first few weeks of November as services and manufacturing firms reported softer demand. Widespread declines in revenues at travel related businesses such as airlines and car rental companies contributed to moderate drops in overall service sector revenues and employment. Manufacturing activity also fell as shipments, new orders, and employment tumbled in October. Automobile sales jumped sharply, while non-automobile sales stabilized, and retailers turned more optimistic about sales prospects for the upcoming holiday season. Residential and commercial real estate activity slowed, although lower mortgage rates buffered the declines. Lending activity was mixed—an increase in refinancings contributed to a pickup in residential mortgage lending, but commercial lending slipped as demand for business loans softened. In agriculture, pastures were in poor condition in many areas as dry weather continued to deplete soil moisture.

Retail: Automobile sales surged, although retail sales outside the automobile sector were mixed. A contact at a department store in Charleston, W.V., reported a drop in shopper traffic and sales, as did a discount retailer in Raleigh, N.C. Several other retailers, however, said shopper traffic was up compared to September levels. A contact at a bookstore in Concord, N.C., reported, “Everybody's decided to go shopping again.” Automobile sales across the District soared as dealers offered zero percent financing and other attractive sales incentives. But an auto dealer in the Washington, D.C. area warned, “When the incentives stop, it'll look like [dealers] shut the front door.” Retail employment dipped in October, and few retailers we spoke with were hiring other than for seasonal help. Retailers, however, turned markedly more optimistic about holiday sales prospects.

Services: Services businesses reported moderately lower revenues and employment since our last report. Airlines, hotels near airports, and car rental firms continued to report weaker demand in the aftermath of the September 11th terrorist attacks. In addition, contacts at freight services firms in Maryland and North Carolina noted softer demand, which they attributed to slower economic growth. Engineering firms in central North Carolina that rely heavily on state government contracts were adversely affected by lower government spending. Contacts at several services firms said that they reduced employee hours and were not filling some vacant positions.

Manufacturing: After two months of slight growth, manufacturing activity contracted moderately in October and the first half of November—shipments, new orders, and order backlogs all declined from their September levels. Output was down substantially in the apparel, chemicals, and

furniture industries. A furniture manufacturer in North Carolina told us that attendance at the October Furniture Market in High Point, N.C., declined by 30 to 35 percent this year and that orders were off by 25 percent. Several textile producers reported weaker sales due to sluggish economic conditions worldwide. Employment in the manufacturing sector fell sharply; one textile producer stated that bankruptcies and plant shutdowns would likely continue for a while in his industry. Prices for manufactured goods were generally flat.

Finance: District loan officers said that commercial lending slowed somewhat in recent weeks while residential mortgage lending picked up as declining mortgage rates spurred refinancings. Several commercial bankers noted that loan demand slipped because many companies had curtailed plans for business expansion in recent months. Few lenders expected commercial demand to pick up in coming months although a commercial lender in South Carolina noted that a number of manufacturers in that area had cut costs sharply and were well positioned for a turnaround. Residential mortgage lending received a strong boost from brisk refinancing activity—a Greenville, S.C., mortgage lender said that refinancings now accounted for 90 percent of his business. Several residential mortgage lenders noted delays in processing loan applications because of the sharp increase in applicants in recent weeks.

Real Estate: Residential realtors and homebuilders reported slower growth in home sales since our last report. A realtor told us that sales in the Washington, D.C., area remained strong in October but that growth had moderated “a bit.” He reported that the area had become a little more of a “buyers’ rather than sellers’ market.” A Richmond, Va., contact said that houses were staying on the market longer and that prices on some were being reduced. Declining mortgage rates made lower priced homes more affordable for first-time homebuyers but did little to boost sales of homes in upper price ranges. In Greenville, S.C., sluggish sales of higher priced homes created a “flood” of inventory according to realtors there.

Commercial realtors across the District reported generally weaker leasing activity. A realtor in Bethesda, Md., described the commercial market as “slow, but steady.” A Richmond, Va., realtor noted that leasing activity in the office sector could be attributed mainly to small firms “taking bites here and there” rather than large firms leasing substantial blocks of space. The availability of Class A office space increased slightly, except in Washington, D.C., where the federal government continued to seek office space for employees recently hired to bolster security and assist in the war effort. Rental rates fell slightly across all sectors, with landlords’ rent and facility upgrade concessions increasingly

becoming the norm. New construction of build-to-suit projects, targeted mainly for small- to mid-sized professional groups such as law practices, increased across the District.

Tourism: District tourism continued to rebound from the steep declines experienced immediately after the events of September 11. There were somewhat stronger bookings for the Thanksgiving holiday—a manager at a resort in Virginia attributed the solid holiday patronage to tourists opting to stay closer to home because of concerns with airline safety. He also told us that East Coast ski resorts should see an increase in patronage because fewer skiers will be traveling to resorts in the west. A contact at a hotel in Myrtle Beach noted that although October and early November bookings were slightly below normal, he expected business over the Thanksgiving holiday to equal or surpass last year's level. Respondents in Washington, D.C., reported that the hospitality industry was finally rebounding—bookings improved and many hospitality workers returned to work in the last few weeks.

Temporary Employment: Contacts at temporary employment agencies generally continued to report relatively weak demand for workers since our last report. Rising unemployment rates in many areas of the District have made it more difficult for some temporary employment agencies to land jobs for workers. An agent in Rockville, Md., said “savvy” employers realize they can pay slightly less now and still attract high quality candidates who are “desperate for work.” While many temporary employment agents expected demand for workers to continue to weaken because of the sagging economy, a firm in Raleigh, N.C., reported that demand over the next six months should increase as some area employers move forward with expansion plans that had been put on hold. He reported an increase in demand for workers in the biotech, financial, and e-commerce industries.

Agriculture: Dry weather has persisted in October and early November, depleting topsoil moisture and causing statewide bans on burning in many areas of the District. In South Carolina and West Virginia, farmers hauled water and fed hay to livestock as pasture conditions deteriorated. In addition, dry weather caused poor germination of small grain crops in North Carolina and Virginia. Dry weather, however, facilitated harvesting of soybeans and corn in many areas of the District.

SIXTH DISTRICT – ATLANTA

Summary: District contacts indicated that economic conditions in the Southeast continued to be weak despite record auto sales in October and the continued resilience of housing markets. Retailers reported that sales growth through mid-November had moderated after a strong rebound in October. The single-family housing market remained solid overall, whereas commercial real estate markets weakened further. Manufacturing production declined and plant closings and layoff announcements continued. Tourist activity rebounded from post-attack lows but fell short of year-ago levels. Few signs of inflation were apparent apart from increased healthcare and insurance costs.

Retail Spending: According to District retailers, sales growth improved considerably in October but then pulled back slightly in early November. Discount retailers continued to fare much better than their department and specialty store counterparts. About one-half of the retailers contacted said that recent sales were below expectations and inventories were high. By most accounts, deep discounting and promotions have become the norm. The outlook for the holiday season amongst retailers remained mixed. Discount merchants' expected modest sales improvements and upscale retailers anticipated flat to lower sales compared with last year.

Auto sales increased to record levels in the District in response to the zero percent financing and extended warranty incentives offered by several manufacturers. Industry contacts reported dramatic gains in October sales compared with a year ago, far exceeding their sales objectives and sharply reducing inventory levels. The pace of sales slowed in early November as the financing incentives narrowed in scope. Record numbers of trade-ins and rental car fleet reductions have caused used car inventories to swell across the District leading to sharp declines in used car prices.

Real Estate and Construction: The single-family housing market remained quite solid through early November with the most positive reports coming from Florida. The demand for low- to mid-priced homes was steady across the District, whereas the demand for high-priced homes softened in markets such as Atlanta and Nashville. Most contacts expected that home sales and new home construction would moderate in the fourth quarter. Office and industrial real estate markets continued to weaken in the face of higher vacancy rates and additional sublease space. Rental rates declined in several markets. Contacts reported that a pickup in commercial construction was not expected until the second half of next year.

Manufacturing: The manufacturing sector continued to trim production and payrolls in October and November. The investment strategies of manufacturers remained conservative, and only essential capital expenditures were undertaken. Many businesses have increased expenditures on security equipment and security personnel. Manufacturers announced layoffs and production cuts in the electronics, automobile, shipbuilding, tire, and building products industries. In one positive development, the U.S. Department of Defense awarded the Joint Strike Fighter plane production to Lockheed Martin, securing jobs at the company's large Marietta, Georgia facility.

Tourism and Business Travel: Contacts reported that the District's hospitality and tourism sector continued to reel from the slowing economy and the impact of the terrorist attacks on air travel. Hotel, car rental agencies, airlines, and cruise lines in central and south Florida have experienced some improvement in business from the record lows following the September 11th attacks but remained well-below normal levels for October and November. A major car rental firm based in south Florida filed for Chapter 11 protection because of a sharp decline in activity. The opening of a large hotel in Orlando was postponed as attendance at local tourist

attractions waned. The travel slowdown also affected hotels in Atlanta and along the Mississippi Gulf Coast. Florida tourism officials are hoping that sales incentives, lower gas prices, and an early, cold winter in the North will improve the state's tourism numbers. Reservations in Florida for the December through April period were on an increasing trend through mid-November.

Financial: Commercial loan demand softened further in the Sixth District according to reports, but mortgage refinancing remained brisk in early November. Deposit growth was sluggish in some parts of the region, and there was some tightening of credit standards for loans secured by commercial real estate. There has been no sign of improvement in the District's venture capital markets.

Wages and Prices: According to reports, wage pressures were subdued in the District. However, hospitals are operating at high capacity and are aggressively hiring nurses, pharmacists, and other health care workers. Some double-digit percentage increases in health care charges and insurance premiums were reported while home price increases moderated. Large price declines were reported for hotel accommodation and other travel-related services. In addition, energy prices decreased sharply across the District, leading to a reduction in gas and oil activity in Louisiana.

Agriculture: The decrease in world demand for textile products and high levels of domestic production has led to some of the lowest cotton prices in the past 25 years. Cotton is the largest cash crop in Mississippi, Louisiana and Georgia. A lower than expected forecast for this season's Florida citrus crop, together with reported disease problems in Brazil, was good news to local citrus growers who had been facing low prices and strong competition from Brazilian producers.

SEVENTH DISTRICT—CHICAGO

Summary. Economic activity in the Seventh District remained soft through October and mid-November. Consumer spending was modest ahead of the holiday shopping season, and some retailers were already discounting merchandise to attract shoppers. Construction activity slowed in recent months, with weakening reported in both residential and nonresidential segments. Conditions in manufacturing industries continued to soften, despite relatively strong light vehicle sales. Home refinancing activity remained very strong, but demand for business loans was said to be waning. Joblessness continued to rise with the slowing economy, and near-term hiring plans were lowered. The fall harvest lagged behind the pace of recent years, but as of mid-November was nearing completion under ideal weather conditions.

Consumer spending. Retail spending was mixed, but generally soft, through October and mid-November as consumers remained value-conscious. Again, discounters reported stronger sales results than general merchandisers. Home entertainment, home improvement, automotive, and toys were said to be sales leaders at retail outlets. Contacts reported that some merchants were aggressively discounting merchandise to get a jump on holiday sales. One large District auto group reported that light vehicle sales were very strong in October, but fell in November, due in part to very lean inventories. Eating and drinking places noted erratic sales results, “day to day and week to week.” Weak business spending was hurting midweek restaurant sales, while longer waits at airports were said to be bolstering sales at eateries inside the terminals. To boost traffic, some restaurants were adding lower-priced choices to their menus which, along with consumers’ recent tendency to “trade down” the menu, resulted in lower average check prices. Business travel generally remained weak, but reports on conventions were mixed. Contacts in some areas reported several event cancellations and lower attendance, while others said there were no cancellations and strong attendance. There were no new reports of intensifying price pressures at the retail level, and one contact indicated that fuel surcharges on some transportation services were discontinued because of moderating oil prices.

Construction/real estate. Overall construction and real estate activity remained relatively weak through October and mid-November. On the residential side, sales of both new

and existing homes were reportedly softer than a year earlier. Contacts reported that sales of lower-priced homes were more resilient than higher-priced homes, due primarily to lower interest rates. Builders' expectations for the near term appeared to be mixed. In some areas, builders were concerned that housing inventories were too low. In others, builders who earlier in the year were anxious to sign contracts to secure scarce home sites with developers, were seeking to get out of these contracts in November. Nonresidential activity was nearly universally soft. Office vacancies continued to rise in most areas and rents were reported to have softened further. The large inventory of sublease space on the market forced landlords to become more flexible in traditional lease agreements. Hotel occupancy rates remained below a year ago, which kept downward pressure on room rates. There were scattered concerns that strong big-box retail development may have outpaced demand in recent months.

Manufacturing. Manufacturing activity softened in October and November, as production and new orders in many industries continued to weaken. However, spurred by heavy incentives, light vehicle sales nationwide topped 21 million units (seasonally adjusted annual rate) in October, a near record month for the industry. Despite extended incentives, sales slowed notably in November and were expected to ease further in December. Many analysts believed that strong sales in the fourth quarter of this year would result in weaker sales next year. Production of heavy equipment, including trucks, slipped further as new orders remained weak. One contact suggested that equipment dealers were "spooked" and continued to draw down inventories. Businesses also continued to work down steel inventories. With steel prices still well below a year earlier, one industry analyst argued that the industry was near bankruptcy. A machine tool contact also noted further softening, but this firm had seen an increase in requests for quotes. Demand for telecommunications and other high-tech equipment remained very weak, with one contact noting that businesses were very cautious and reluctant to spend money.

Banking/finance. Overall lending activity remained sluggish, despite very strong mortgage refinancing activity. Mortgage interest rates dipped to new lows in late October/early November, spurring record levels of refinancing activity, according to contacts. Bankers noted that many consumers were taking this opportunity to consolidate loans, resulting in relatively weaker demand for other types of household loans such as home-equity, personal, and credit card

loans. Lenders also reported that demand for new mortgage originations was fairly soft. Consumer credit quality continued to deteriorate with delinquencies rising across loan categories, and personal bankruptcies were said to be increasing as well. Insurance companies noted increased demand for nearly all types of policies, particularly life insurance, following the September 11 tragedies. On balance, business loan demand remained soft. One banker noted slightly increased consolidation activity in some manufacturing industries. In general, however, loan demand was being held down by businesses' reluctance to expand. Bankers credited low interest rates with keeping some companies profitable, but overall business loan quality continued to deteriorate, with one lender suggesting that most of the difficulties were concentrated in large corporations.

Labor markets. Labor markets continued to slacken through mid-November, with weakness in nearly all industries and occupations. Initial unemployment insurance claims remained well above year-ago levels in all District states, as did continuing claims. In addition to furloughing workers, firms were also seeking to cut labor costs by eliminating or significantly curtailing employee training and related travel. After struggling in recent years to find qualified help, one company was offering some workers sabbaticals (at substantially lower pay) in hopes of still having them on its payroll when business eventually picks up. Retailers reported greater success in meeting their more modest holiday staffing needs than in recent years. A national survey showed that first quarter 2002 hiring plans of employers in the Midwest were the lowest since the early 1980s. Especially weak hiring was expected for manufacturing industries. There were no new reports of intensifying pressure on wages or other employment costs.

Agriculture. The soybean and corn harvests were nearly complete by mid-November. The remaining harvest in the northern portions of the District, while lagging behind that of recent years, was progressing rapidly in unseasonably favorable weather conditions. Corn and soybean prices at the farm gate remained below year-ago levels as of mid-November, but had moved up modestly from a month earlier. Beef and pork prices continued to weaken from both month- and year-ago levels. Milk prices remained high by recent standards, although the October average slipped from the recent high in September. Milk production in the District declined again in October, more than offsetting an aggregate increase in the 15 other major milk producing states.

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Eighth District - St. Louis

Summary

Economic activity in the District has been buoyed by stronger than expected retail sales, although the manufacturing sector has continued to weaken. Retail sales were generally higher in October compared with a year earlier, with sales at or above most retailers' expectations. Sales of new automobiles in the month were much higher than average, which dealers attribute to manufacturers' incentives. The residential real estate sector remains relatively strong, although weakness is appearing in some parts of the District. New housing permits, though, continue to be higher than a year earlier. Commercial real estate markets have continued to weaken, and vacancy rates for commercial space have risen. Total loans by small and mid-sized banks were up modestly, along with deposits. Despite heavy rains in some parts of the District, the fall harvest of many crops is nearly complete, and the winter wheat crop is rated as good-to-excellent.

Consumer Spending

Contacts report that spending in October was slightly higher than at the same time last year. More than one-half of the retailers surveyed noted that the increase in sales was above expectations, while a little more than one-third felt that they were below. Toys, electronics, home furnishings, children's apparel, and basic items were strong sellers, while jewelry, gift-type items, and tourist-related products were moving slowly. Retailers were about evenly split between those with inventories at desired levels and those with excess inventory. Several contacts reported that discounting and promotions would be used to move the excess items. With the holiday season coming up, retailers are cautiously optimistic about sales for the rest of the year: Some expect a small, single-digit increase in sales from last year, while others expect sales to remain flat from 2000.

Car dealers in the District report that sales were above average for October, following below-average sales in August and September. Almost all contacts attribute this to financing incentives and rebates offered by manufacturers. Because of these incentives, new car sales in October were much better than used car sales. A few contacts saw an increase in the rate of acceptance of finance applications, but

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most noted no change. Dealers indicate that their optimism about future sales depends on the continuation of manufacturers' incentives.

Manufacturing and Other Business Activity

The District's manufacturing sector continues to be weak. Companies are still experiencing difficulty generating profits because of reduced orders. Consolidation, cutbacks, and closings remain commonplace. Affected industries include auto and tire, boat, appliances, electronic materials, clothing, metals, chemicals, and other durable goods manufacturers. Most contacts report low consumer confidence and a "wait and see" period. On the bright side, there are reports of steel, furniture, plastics, and printing companies hiring, expanding, or moving into the District.

Districtwide, the services sector continues to experience slow-to-no growth. To cut costs, several contacts noted that they are reducing their advertising expenditures. The communications sector is mixed: While still posting positive growth for long distance, wireless, and data services, contacts report that communications companies are decreasing capital spending and are consolidating. Contacts are not expecting much of an upturn, if any, in 2002. The travel-related service sector (airlines, travel agencies, motels, etc.) is still experiencing reduced volume following the attacks of September 11. Contacts, however, hope to see an increase in business during the upcoming holiday season. Although the trucking industry continues to see less freight, the decrease in fuel prices is helping to maintain costs.

Real Estate and Construction

Residential real estate sales remain mixed across the District. New homes priced below \$250,000 continue to sell well in Little Rock, while Memphis realtors reported a slight decline in September closings. Sales in Louisville are down from the same period a year ago, and a surplus of homes in the Mississippi region is creating a buyer's market. Buyers and potential tenants for commercial real estate are cautious in Little Rock. The Memphis industrial and warehouse market experienced a very high absorption rate over the second quarter of 2001 and continues to offer plenty of distribution space. However, the vacancy rate for the St. Louis market has continued to rise through the end of the third quarter, as it had since the beginning of the year.

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Residential construction opportunities continue to expand through most of the District as year-to-date permit levels are higher than a year earlier. In contrast, the District's commercial construction opportunities are generally diminishing, although exceptions include the areas of western Arkansas and Memphis, where this activity remains strong. In response, contractors in some portions of the District are moving from industrial projects to local government projects.

Banking and Finance

Total loans outstanding at a sample of small and mid-sized District banks were up modestly, increasing by 1.7 percent between mid-August and mid-October. This stems primarily from a 70 percent increase in interbank lending. Contacts have also reported a modest increase in real estate loans of about 1.4 percent, while commercial and industrial loans have declined modestly over the period—by about 0.5 percent. At the same time, total deposits at these banks were approximately 1.7 percent higher.

Contacts in Little Rock have also reported a strong demand for mortgage refinancing, residential lending, and car loans. Actual earnings are between 5 and 15 percent below projected earnings for banks in west Tennessee. Contacted banks in northeastern Mississippi have reported good profits, but are experiencing greater loan delinquencies and recording more bankruptcies.

Agriculture and Natural Resources

The fall harvest of corn, soybean, cotton, and rice crops is nearly complete throughout the District, despite being delayed by several episodes of heavy rain during mid-to-late October. Reports indicate that October was the second, third, and seventh wettest on record in Indiana, Illinois and Kentucky, respectively. Because of the availability of storage space and the long harvest period, no grain transportation difficulties have occurred. While rainfall delayed the planting of the final winter wheat crop, it aided the planted crop's germination and growth and replenished moisture deficits. On average, the District winter wheat crop is rated as being in good-to-excellent condition.

NINTH DISTRICT--MINNEAPOLIS

Economic activity in the Ninth District decreased in late October and early November. Commercial real estate, agriculture, energy and mining are down. Manufacturing, tourism and consumer spending are down slightly, although auto sales are strong. Labor markets weakened as a result of additional layoff announcements. Overall wages and prices are stable, with the exception of increases in health care and property insurance rates and decreases in cattle hide prices.

Construction and Real Estate

Commercial construction is slower than a year ago. The value of commercial construction projects in October was lower than last year in Billings, Mont., and Sioux Falls, S.D., according to city officials. A commercial real estate consultant reported that the office vacancy rate in downtown St. Paul recently increased to 8.1 percent compared with 5.5 percent a year ago. Expansion plans at the Minneapolis-St. Paul International Airport were delayed during September and October, affecting contractors who would have bid on more than 50 projects. However, a Minneapolis area commercial construction company reported continued profits and a steady workload in the fourth quarter.

Homebuilding is slightly higher than a year ago in several parts of the district. The value of permits in October was higher than a year ago in Billings and Sioux Falls, while the number of permits was slightly higher in Minneapolis-St. Paul. However, October sales of existing homes in the Minneapolis-St. Paul area were down 3 percent compared with last year.

Consumer Spending and Tourism

Retail sales are generally slower, except for strong auto sales. A Minnesota-based leather products retailer reported that same-store sales in October were down 5 percent compared with last year. An economic development official noted that October retail sales were down from a year ago in Sioux Falls. A Helena branch director said that merchants are anticipating slower Christmas sales compared with last year. In contrast, a major Minneapolis-based department store retailer reported that overall same-store sales in October were up 2 percent compared with a year earlier. A Montana mall manager noted above-average traffic in October compared with last year.

Auto dealers reported that new car sales reached high levels. October new car sales in the Dakotas increased from September due to manufacturer incentives, according to auto dealer association representatives. One representative described October as a “barn-burner,” but is concerned about future sales. A Minnesota dealership noted that buying activity in November is at a more traditional rate following October’s frenzied pace.

Tourism activity is down for fly destinations and generally level for drive destinations. A bank director reported that recent air traffic at a central Montana airport is at a 20-year low. Hotel occupancy in St. Paul was off about 10 percent in October compared with a year ago, according to a convention and visitors bureau representative. Fall tourism was down slightly in the Upper Peninsula of Michigan, but inquiries for winter tourism activity are solid, according to an official. Tourism activity in the Black Hills area of South Dakota was up about 5 percent in October compared with last year.

Manufacturing

Overall manufacturing activity is down slightly. An October survey of purchasing managers by Creighton University indicated small decreases in manufacturing activity in Minnesota and North Dakota and increased activity in South Dakota. A Minnesota maker of heating and cooling systems will close, and a northwestern Wisconsin manufacturer of napkin-folding machinery is reducing output. A Montana mill that manufactures studs for housing is shutting down for two weeks, and a northwestern Wisconsin wood products plant has temporarily closed. In addition, preliminary results of the Ninth District’s annual (November) business conditions survey reveal that two of three manufacturers are pessimistic about their community’s economy. However, a surgical equipment manufacturer in the Upper Peninsula plans to expand production and employment.

Mining and Energy

Activity in the energy and mining sectors is down. Early November district oil and natural gas exploration and production levels are behind the levels of early October. A large northern Minnesota iron ore mine reduced production starting in mid-October due to weak orders by steel producers; an iron ore mine in the Upper Peninsula plans to decrease output in January. In addition, a Montana platinum mine reduced production.

Agriculture

Agricultural conditions have deteriorated. “Cattle prices have dropped about 10 percent over the last month, which will adversely affect many of our customers’ ability to repay

loans,” reported a Montana lender in the Minneapolis Fed’s third quarter (November) agricultural conditions survey. The preliminary results of the survey indicate poor financial performance, as half the respondents reported that agricultural customers had below-normal profits over the past three months, while only 8 percent reported above-normal profits. In addition, agricultural bankers reported that 27 percent of their farm customers are at their debt limit.

Employment, Wages and Prices

Additional layoffs have been announced since the last report. In early November an HMO in Minnesota reported plans to lay off about 230 employees, and a company that provides materials-management products to semiconductor firms plans to reduce staff positions by 100. As a result of a major acquisition, a packaged-food company will eliminate about 300 jobs. A faith-based association recently announced plans to move its Minneapolis headquarters to a different state, affecting 440 employees. A manufacturer in southwestern Wisconsin laid off 100 workers in October, but recently called 15 back to work. Initial Minnesota unemployment claims increased 91 percent in October compared with a year ago.

In contrast, a health insurance company plans to expand operations in northern Minnesota, adding about 200 jobs. A home mortgage company will add 100 jobs in Minneapolis due in part to increased refinancing activity.

Increases in wages and salaries are moderate. Only 10 percent of respondents to a survey of manufacturers in Minnesota, Wisconsin and the Dakotas reported higher wages in October, down from 35 percent a year ago. According to preliminary results of the Minneapolis Fed’s business conditions survey, almost 95 percent of respondents (up from 67 percent a year ago) expect wages to increase no more than 3 percent in 2002.

Price changes are modest, except for notable decreases in cattle hides and increases in health care and property insurance rates. Prices for cattle hides and skins dropped almost 8 percent in October compared with a month earlier. Health care costs for employers in the Minneapolis-St. Paul area are expected to finish the year up 7.1 percent compared with the previous year, according to a consulting firm. Several bank directors reported recent significant increases in property insurance rates. According to the October survey of manufacturers in Minnesota, Wisconsin and the Dakotas, 19 percent of respondents reported recent increases in product prices, down from 28 percent a year ago.

TENTH DISTRICT - KANSAS CITY

Overview. The Tenth District economy remained generally sluggish in late October and early November, though not all signs were negative. Manufacturing activity continued to languish, commercial real estate activity weakened, and energy activity slowed further. However, auto sales surged in most of the district due to consumer incentives, and retail sales and housing activity rebounded somewhat from the dropoff following the terrorist attacks. In the farm economy, a dry autumn limited forage supplies and raised concerns about soil moisture going into winter. District labor markets continued to ease, as further job cuts took effect. Wage pressures also remained subdued. Price discounting at many stores held retail prices in check, and prices for finished factory goods edged lower due to weak demand. Prices for most construction and manufacturing materials were stable.

Retail Sales. Retail sales improved somewhat in late October and early November but remained close to year-ago levels in most areas. Large discount stores continued to enjoy the strongest sales. Most retailers were cautiously optimistic heading into the holiday shopping season, saying they expected to match or slightly exceed last year's sales numbers. Home improvement stores were especially upbeat. Some retailers, however, reported they were aggressively managing inventories to avoid being stuck with excess stocks in January. Motor vehicle sales were very strong across the district due to attractive financing packages. However, dealers expect overall vehicle sales to weaken considerably once the consumer incentives come to an end. Some rental car companies reported scaling back new car purchases and selling off some of their used vehicles due to cutbacks in air travel.

Manufacturing. District factory activity was flat in late October and early November after declining substantially over the summer. A similar percentage of firms as in the previous survey reported lower production, shipments, and new orders compared with a year ago. However, more manufacturers were shedding workers than in recent months, as further layoffs were announced at a wide variety of firms. Food processing remained an exception to the slowing trend, with output and employment generally holding steady.

Expectations for future activity remained subdued, and firms continued to hold back on capital spending projects. Most firms continued to trim inventories and expect to trim further in coming months. No significant shortages of materials were reported, and supplier delivery times declined for some products.

Real Estate and Construction. Residential construction activity rebounded somewhat from the dropoff following the terrorist attacks, while commercial real estate markets weakened further. Compared to a year ago, both home sales and housing starts were up solidly in Oklahoma and New Mexico. Housing activity in most of the rest of the district remained below year-ago levels, but somewhat less so than in the previous survey. Sales of high-end homes remained particularly weak throughout the district. Commercial real estate activity continued to decline, as white-collar layoffs and uncertainty about the economic outlook further reduced the demand for office space. High office vacancy rates were of particular concern in areas of suburban Denver hard hit by high-tech layoffs. New office construction has also slowed in most cities since the summer.

Banking. Bankers report that loans decreased and deposits held steady since the last survey, reducing loan-deposit ratios. Demand fell for all loan categories except home mortgages, which benefited from strong refinancing activity. On the deposit side, increases in demand deposits, NOW accounts, and money market deposit accounts were offset by declines in large CDs. Almost all respondent banks reduced their prime lending rates and consumer lending rates since the last survey. Lending standards were unchanged.

Energy. Energy activity in the district fell considerably in late October and early November. By mid-November, the region's count of active oil and gas drilling rigs was down roughly a third from the 14-year high established in July. The slowdown in drilling activity is now evident in all oil and gas producing areas of the district, after starting out in marginal fields only. District sources report, however, that they expect the declines in activity to be short-lived, with energy prices stabilizing in 2002.

Agriculture. District corn and soybean yields were average or better, except in southern parts of the district where dry summer weather hurt the crops. Rain came in time for planting of the district's winter

wheat crop, but a dry autumn has raised some concerns about soil moisture going into winter. Dry conditions have also limited forage supplies in some areas, encouraging ranchers in those areas to send more cattle to market despite weaker prices this fall. Otherwise, cattle producers are holding off on marketings until prices recover. District bankers indicate that small business activity in rural areas is slower than a year ago.

Wages and Prices. District labor markets continued to ease in late October and early November, as previously announced layoffs went into effect and firms cut back on new hiring. The rate of new layoff announcements subsided somewhat from September but remained much higher than earlier in the year. Employers were having few problems hiring most kinds of workers, although shortages persisted for nurses and some skilled building trades. In a change from the previous survey, retailers now expect to hire a similar number of seasonal workers as in previous years. Wage pressures remained subdued, and many firms reported they would not be giving holiday bonuses this year. Due to rising health care costs, some firms were trimming medical and other benefits. Retail prices remained basically flat, although some stores continued to lower prices to clear excess inventory. Most store managers expect similar prices through the remainder of the year. In the manufacturing sector, materials prices were steady while finished-good prices continued to edge down, a trend that most firms expect to continue. Builders in some areas reported substantial declines in lumber prices, but prices for most other construction materials were largely unchanged and are expected to remain flat in coming months.

ELEVENTH DISTRICT—DALLAS

Eleventh District economic activity slowed somewhat from mid-October to mid-November. Many contacts mentioned that economic uncertainty is discouraging business and consumer spending. Some contacts said they do not expect a pickup in activity until the second half of 2002 or later. Manufacturing activity declined slightly, and demand for business services continues to slow. Retail sales continued to be well below plan for many stores. Construction and real estate activity continued to slow, and the energy industry continued to weaken. Financial service firms reported little change in loan demand. Rains improved agricultural conditions in some locations, but most areas remained dry.

Prices and Labor Markets. Prices are lower for many manufactured products, including steel, paper, cement, glass and some high tech products. Further price declines are expected in the near future for some products. Cost pressures were also lower, with many industries reporting lower prices for utilities, fuel and shipping. As of mid-November, crude oil inventories were up 3 percent since September 11th, and contacts say markets remain concerned that demand may fall further. Heating oil inventories were up 4 percent. The retail price of gasoline fell over 25 cents at the pump since the last Beige Book, to the lowest level of the last two years. Gasoline inventories were up 6 percent.

Labor markets loosened significantly, and contacts say wage pressures have slackened for the first time in a long time. Many firms say they are not hiring, and several retailers say they expect to hire fewer extra holiday workers. Layoffs and early retirement incentives continued in the transportation and telecommunications industries, where some firms have reduced executive pay.

Manufacturing. Overall manufacturing activity declined slightly. Paper producers reported little change in sales in late October and early November, which are down significantly from a year ago. Apparel manufacturers reported strong sales to discount stores, but slowing sales to other vendors. Only food manufacturers reported stronger than expected demand.

Most high-tech manufacturers said that, in early November, sales had flattened following some moderate declines after September 11th. The weakening economy and increased uncertainty since the terrorist attacks have pushed back the expected recovery of their industry from the first quarter to the third quarter of 2002. While most high-tech firms continued to cut jobs, the rate of layoffs is slowing. Selling prices are weak, but several firms noted that prices for memory chips are firming. Most respondents said inventories are very lean. Telecommunications firms said

demand continued to decline over the past month, down 20 percent to 30 percent. One contact said demand is down 80 percent from this time last year.

Most construction-related manufacturers, including brick and lumber, reported a drop in demand between mid-October and mid-November, mostly due to slower home building. New orders for cement also declined, although the industry continues to supply projects delayed by rain in August and September. Glass sales were “decent” according to contacts who expect sales to slow with home building. Demand for primary and fabricated metals fell, partly due to declining energy activity. Production of metals has been unchanged, however, because manufacturers have been reducing backlogs. One contact said a lot of the existing activity is related to government contracts.

Refiners increased output seasonally on the Gulf Coast in October. Margins declined slightly from moderate levels in September. Petrochemical producers reported little change in activity. Demand remains weak, but there was some indication of a pickup in the third quarter, mostly because lower input costs had improved the international competitiveness of domestic producers. Still, a large overhang of capacity has kept profit margins weak because any cost savings from lower natural gas prices is being passed on to customers.

Services. Service sector activity continued to slow. Only legal firms reported strong demand for their services, particularly for bankruptcy and credit activities. Temporary service firms say activity has slowed faster than expected. Transportation firms reported continued declines in passenger and cargo shipping volume. The trucking industry has become more pessimistic, expecting shipments to slow over the next three months due to slowing in home construction.

Airline passenger volume remains significantly lower than the levels reported three months ago. Business travel has decreased, with travel to Asian and European markets weakening. Airfares have been reduced in an effort to stimulate passenger volume, but costs are up, due to stricter security and other regulations.

Retail Sales. Retail sales as of mid-November continued to be well below plan for most stores, and contacts say profits are suffering. Sales are still strongest at stores that are perceived to offer value and stores that are perceived as safer, such as those away from malls. Consumers remained focused on purchases of consumables and items that are perceived as not frivolous. Contacts say selling prices are unchanged or slightly lower, with the only cost pressures coming from soaring property insurance and health care costs. However, one contact noted that margins are shrinking for many suppliers and there may be a lot of pent up inflation when demand picks up.

Auto dealers reported record sales, fueled by zero percent financing. All contacts expressed concern that the market has been saturated, and dealers said that sales are already slowing despite an extension of the financing incentives through mid-November. The used car market has held up surprisingly well, according to contacts, because some people do not qualify for zero percent financing.

Financial Services. Financial service firms reported little change in lending demand in late October and early November. Deposit activity remained at a level somewhat higher than reported earlier this year. Loan prepayments continued to be stronger than usual, and money received from transfers out of brokerage accounts have accelerated. There were no reported changes to delinquency rates or other indications of a slowdown in bank performance measures.

Construction and Real Estate. Construction and real estate activity continued to slow. Single-family builders reported a strong pick up in sales volume, spurred by low interest rates, incentives, and price cuts. Still, cancellation rates remained high—from 20 percent to 40 percent—compared with the rate before to September 11th. Nonresidential activity continued to decline. Rental rates continued to fall, and there is no new construction being planned, according to contacts who say markets are expected to get worse before they get better.

Energy. Energy activity has gone from overheated to very cool in a short period of time, according to contacts. The U.S. rig count fell in mid-November to near 1000 working rigs from 1300 in late July. Utilization rates for rigs in the Gulf of Mexico have declined to just under 60 percent from over 90 percent in the spring. As the result of weaker demand, prices for oil services and rigs have weakened, although strong pockets of domestic activity and high levels of activity in international markets are propping up revenues and profitability. Companies reported that they are delaying layoffs, hoping for a quick rebound in the demand for natural gas along with the U.S. economy.

Agriculture. Rains improved agricultural conditions in some locations, but most areas remained dry. Harvesting of remaining summer crops continued, and planting of small grains was under way. Many areas were short on planting moisture, however, and emergence was not expected because soil moisture was inadequate. Some replanting was under way. Range and pasture conditions declined as dry weather continued, and supplemental feeding of livestock continued to increase. Hay shortages were becoming more widespread. Herd reduction continued to be necessary in some areas as a direct result of dry conditions.

TWELFTH DISTRICT – SAN FRANCISCO

Summary

Economic activity remained weak during the survey period of October and early November, although signs of further deterioration in economic conditions compared with September were limited. Prices fell for some items, largely due to discounting by retailers and service providers, with little or no upward movement overall. Wage increases were limited. Retail sales and travel spending picked up noticeably compared with September but, with the exception of strong auto sales, remained weak. Manufacturing output and employment declined further. Agricultural products were in ample supply, and some producers struggled with low sales prices. Demand for commercial real estate declined in most areas, and residential real estate markets cooled, although home prices generally remained firm. Loan demand fell on net, due to weaker demand from businesses.

Wages and Prices

Upward pressure on wages and consumer prices was limited during the survey period. The prices of some items fell—most notably for energy, hotel rooms, and airline, cruise line, and tour tickets—and contacts in most areas reported widespread discounting by retailers. Wage increases were quite limited, with lower starting salaries reported in some areas; one respondent in the Pacific Northwest noted a 20 percent reduction in starting salaries for high-tech workers during the past 12 to 18 months. Contacts also provided scattered reports of salary freezes for current employees. Although labor costs associated with health benefits rose, the rate of increase was reduced somewhat by medical plans' increased reliance on lower-cost generic drugs.

Retail Trade and Services

Consumer and travel spending were weak during the survey period, with the exception of

new automobile purchases. Reports generally indicated that retail sales were several percentage points below pre-September 11 or year-earlier levels, although substantial recovery compared with the second half of September was noted for all areas. Sales were especially low at restaurants and for most categories of apparel. Moreover, retailers' orders for Christmas items and their hiring activity for the early holiday season were both below normal. The exceptions to generally weak retail sales reports were provided in regard to large discount retailers, who saw flat to slightly increased sales, and auto dealers, for whom favorable financing terms generated a surge in sales. In Hawaii, retail spending reportedly was as much as 20 percent below normal, due primarily to weak visitor arrivals rather than reduced spending by residents. In that state, domestic visitor counts were well up from September but remained about 10 to 12 percent below year-earlier levels, while Japanese visitor counts remained stuck at 50 to 60 percent below normal. Among signs of weak travel spending in other areas, San Diego's visitor tax revenues were down 27 percent in October compared to a year earlier, and holiday season bookings reportedly were weak in Arizona. Firms in the travel industry (including airports) laid off large numbers of employees, and a Southern California respondent noted that voluntary turnover in the travel industry was unusually low.

Service providers outside the travel industry also faced weak conditions. Business was slow for advertising, marketing, public relations, management consulting, and computer services firms throughout the District, and these firms implemented significant job cuts. Providers of telecommunications services, including high-speed Internet services, also faced weak demand.

Manufacturing

Manufacturing activity contracted further during the survey period. High-tech manufacturers reduced their inventories, bringing them closer to preferred levels, and

semiconductor prices reportedly stabilized at very low levels. However, sales of high-tech equipment fell and substantial layoffs continued in that sector throughout the District. Demand for wood products fell sharply in October, and sales of other construction-related materials such as paint and coatings reportedly were 3 to 5 percent below year-earlier levels. Apparel makers have worked down their inventories somewhat, but production capacity was underutilized due to weak demand. Job cuts were widespread in manufacturing, including the onset of Boeing's extensive planned cuts in the Seattle area and Southern California.

Agriculture and Resource-related Industries

Conditions in agriculture changed little, with ample supply and low prices as dominant factors. Demand was solid for most agricultural products, as strong sales to supermarkets reportedly offset substantially depressed sales to the food services industry (primarily restaurants). Growers of fruits, vegetables, and other field crops worked down inventories somewhat, but prices remained quite low, especially for cotton. An Arizona contact reported low prices and losses of \$200 per head on beef cattle. By contrast, due to tighter supply than in past years, the prices of grains and potatoes increased, benefiting suppliers in Idaho and the Pacific Northwest. In California, the supply of agricultural labor shrank somewhat due to reduced net migration from Mexico.

Real Estate and Construction

Real estate markets cooled and construction activity fell in most areas of the District during October and early November. Demand was especially weak for commercial space, with rising vacancy rates, declining rents, and reduced construction activity evident in most areas, especially in the previously hot markets of Seattle and the San Francisco Bay Area. A construction industry contact from Seattle reported that his company's West Coast commercial

building contracts were down 30 percent compared with a year earlier, and the company recently implemented its first major layoffs in ten years. Moreover, due to reduced travel demand, hotel and resort construction projects have been postponed or canceled in Hawaii and California. On the residential side, contacts provided widespread reports of price reductions for high-end properties; prices for less expensive homes generally remained firm, although average time on the market increased. Residential building activity fell in most areas, although the level remained high in some places, notably Southern California and Idaho. Industry contacts generally expect further reductions in construction activity next year, after existing project backlogs are worked down.

Financial Institutions

Loan demand fell on net during the survey period. Loan demand by businesses declined markedly in most areas, which more than offset a surge in demand for real estate refinance loans spurred by low interest rates. Brokerage houses and other investment firms have been struggling with low returns and responded with a substantial number of layoffs during the survey period.