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Summary of Commentary on

Current Economic Conditions

by Federal Reserve District

January 2002

SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICTS

JANUARY 2002

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SUMMARY[1]

Reports from the Federal Reserve Districts suggest that economic activity generally remained weak from late November through early January. But while there are still indications of caution, there are also scattered reports of improvement. The Dallas and San Francisco Districts report a continued decline in activity, while the Cleveland District indicates that the regional economy appears to be in the process of bottoming out. Economic activity remained slow or weak in the Boston, Chicago, Philadelphia, Kansas City and St. Louis Districts. Activity was mixed according to the Atlanta, Minneapolis and Richmond Districts and showed further signs of rebounding in the New York District.

Many Districts indicate that their contacts believe a recovery will begin by mid-year or earlier, but the timing and strength are uncertain. Several Districts say that uncertainty has led some businesses to budget conservatively for the first quarter.

Manufacturing activity was weak or down in most reports, but showed signs of stabilizing or rebounding in several Districts. Retail sales picked up in late December and early January but for the period overall posted generally weak results in most Districts. Auto sales slowed in December—after very strong sales in October and November—but sales remained relatively strong. Construction and real estate activity continued to soften in most Districts. Commercial real estate markets continued to weaken, and while housing markets held up overall, there was further weakness concentrated in the markets for higher-priced homes. Reports on the service sector were mixed but in general suggest sluggish economic

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[1] Prepared at the Federal Reserve Bank of Dallas and based on information collected before January 9, 2002. 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.

activity. Financial institutions reported a slight softening of conditions in late November and December. Drilling activity continued to contract rapidly in response to lower energy prices, and the airline industry continued to suffer from weak demand and soaring security costs.

Labor markets remained soft. There are numerous reports of shrinking wage and benefit packages. The Cleveland District notes that employers are invoking "economic duress" clauses to renegotiate union contracts. Most Districts report declining prices for goods and services with the notable exception of sharply rising prices for security, health care, and all types of insurance.

Consumer Spending. Retail sales showed signs of improvement in late December and early January but results were generally weak overall in most Districts. Sales were flat or down compared to last year in the Boston, Richmond and St. Louis Districts. Sales were "mediocre" in Atlanta, "weak" in Dallas, "soft" in Chicago, "slow" in St. Louis and "lackluster" in San Francisco. Sales were up, however, and better than expected in the Cleveland, Kansas City, New York and Philadelphia Districts.

According to most Districts, there were aggressive promotions and unusually large discounting that reduced profit margins for retailers. The flurry of sales activity in late December and early January left inventories in good shape. Sales were strongest for home furnishings and electronics according to District reports. Sales of menswear were weak, and warm weather discouraged purchases of winter apparel and seasonal sporting goods. Discount stores continued to report stronger sales than apparel or high-end retailers. The Dallas, Boston and Philadelphia Districts note that retailers have reduced purchases for the first half of 2002 in anticipation of weak sales.

Auto sales were slower in December after very strong sales in October and November. Several districts report that sales had remained relatively strong, however, and a few Districts note that December sales were above year-ago levels. The Cleveland, Dallas and Kansas City Districts say their contacts expect first-quarter sales to weaken. The Atlanta, Kansas City and Minneapolis Districts note that inventories of used cars are high due to the large number of trade-ins that occurred in October and November. As a result, used car prices have fallen.

Manufacturing. Manufacturing activity was weak or down in nearly all Districts. Demand is lower for machine tools, metals, textiles, telecommunications and most aircraft equipment. But there are some signs of stabilization or recovery in many reports. For example, the Cleveland District says that the number of manufacturers reporting increases in new orders rose from November to December. In the Atlanta District, several firms noted a modest pickup in new orders and were rehiring some of their recently laid-off staff.

Auto production was mixed but showed indications of picking up. In the Atlanta and Cleveland Districts, some plants worked overtime hours to meet booming demand for their models, while others were forced to close for two weeks because of slumping sales of the models produced at those plants. The Chicago District reports that manufacturers said nationwide light vehicle sales exceeded their expectations again in December despite softening from November. Inventories remained very lean, according to the Chicago District, where one manufacturer indicated that its light vehicle production in the first quarter of 2002 would be 6 percent to 7 percent higher than a year earlier. Demand for some high-tech products has improved since the last survey, according to the Dallas and San Francisco Districts. The Boston and Atlanta Districts report an increase in demand for medical and security-related products, while the Chicago District reports a late-December pickup in steel production.

The reports also suggest more optimism among the country's manufacturers, with many predicting a pickup towards the end of the first half of 2002. A higher percentage of plant managers in the Kansas City District expect increases in production than in earlier surveys. Manufacturers in the Philadelphia District indicate that they have slightly raised capital spending plans for the first half of the year in anticipation of an upturn by the middle of the year. Most contacts in the Cleveland District also expect conditions to improve late in the second quarter or early in the third quarter. Richmond manufacturers anticipate that shipments, new orders and capital expenditures will increase substantially by mid-year. In contrast, most manufacturers of heavy equipment in the Chicago District cut their forecasts for 2002. And, the Boston District reports that capital spending will be tight or reduced significantly according to a majority of their respondents.

Services. Reports on the service sector were mixed but in general suggest weak economic activity. The Cleveland and Dallas Districts report slow demand for temporary workers. Temporary employment agencies in the Richmond District, however, report somewhat stronger demand for most categories of workers.

Transportation and tourism activity was reported to be rebounding in December, but demand remains well below year-ago levels according to the Atlanta, Dallas, Minneapolis, New York, St. Louis and San Francisco Districts. Hotel occupancy rates picked up but are still below a year ago. Business travel remains down, according to the Dallas and San Francisco Districts. But, price cuts stimulated a pickup in leisure travel over the holidays and flights were fuller, according to the Chicago District. The Dallas District notes that the airline industry has significantly reduced capacity over the past two months. With 15 percent fewer aircraft in service compared to a year ago, industry capacity is now at roughly 1997-98 levels. Weak demand has pushed revenues down 15 to 20 percent below last year's levels. Depressed revenues along with soaring security costs have significantly hurt earnings.

Construction and Real Estate. Housing markets continued to hold up in most Districts, although there were pockets of weakness, particularly for higher-priced homes. Commercial markets were softer, with the Atlanta, Chicago, Kansas City, New York and Richmond Districts reporting higher office vacancy rates. The Atlanta and New York Districts report an abundance of sublease space, while office rents were lower in the Richmond District. The Chicago and Kansas City Districts say that landlords are offering more generous tenant improvement packages that may be masking the full extent of rent declines in the commercial market. In contrast with other reports, the Cleveland District reported "uncharacteristically strong" building activity.

Banking and Finance. Financial institutions indicated a slight weakening of conditions in late November and December. Soft or declining loan demand is reported in the Chicago, Cleveland, Kansas City, New York, Richmond, St. Louis and San Francisco Districts. Competition for quality borrowers remained intense, according to the Cleveland and San Francisco Districts. Demand for commercial loans remained weak. Consumer lending has held up in this recession, but it began to soften at the end of December as higher mortgage rates choked off the surge in refinancing activity. Only the Philadelphia District reports rising loan volumes. The Cleveland and San Francisco Districts indicate some deterioration in asset quality, and the Atlanta and Cleveland Districts note some increase in delinquency rates. Tightening credit standards are reported in the Chicago, New York, Philadelphia and St. Louis Districts.

Agriculture and Natural Resources. The Kansas City, Minneapolis and St Louis

Districts note concern about the absence of a protective snow cover for the winter wheat crop. The crop may already have been damaged, according to the Kansas City and St. Louis Districts. Dry weather in the Kansas City District has limited pasture growth, causing most ranchers to be reluctant to expand their cattle herds. Rain and snow helped replenish depleted soil moisture levels and improved the condition of small grain crops in the Richmond District.

Bankers in the Richmond District said low crop prices continue to leave some farmers financially vulnerable. Livestock producers have benefited from lower feed costs and lower prices for nitrogen fertilizer, however. The St. Louis District notes that the price of natural gas—a major cost component in the production of nitrogen-based fertilizer—fell by approximately 75 percent compared with last year. Government payments to crop producers and strong livestock profits in the first half of 2001 will provide some offset for weakness in farm loan portfolios, according to bankers in the Kansas City District.

Drilling activity continued to decline rapidly in response to lower energy prices, according to the Atlanta, Dallas, Kansas City and San Francisco Districts. The U.S. rig count fell from over 1000 working rigs in early November to 887 at year-end. Capital spending in 2002 is expected to be down by more than 20 percent according to the Dallas District.

The San Francisco District reports that interest in siting and building electrical power plants has slowed, with some developers backing off their "fast track" approach and taking a more wait-and-see attitude. An iron-ore mine in the Upper Peninsula of Michigan and a mine in Northern Minnesota both extended a shutdown, according to the Minneapolis District, while another mine in Northern Minnesota ended an eight-week shutdown but is operating at reduced production levels. Several Kansas City District firms report expansion of coal-bed methane exploration activity.

Labor Markets. Labor markets remain soft, according to most District reports. Further layoffs are expected in the Boston District, but the Chicago and New York Districts say labor markets are stabilizing.

While there were reports of shrinking pay increases in the Chicago District, some firms are freezing pay scales in the Boston District, and downward wage pressures are reported in the Cleveland, Kansas City and San Francisco Districts. These Districts report the elimination of hiring bonuses, decreases in moving allowances and reduced merit increases. Employees are also being asked to pay a larger share of health care and other benefit costs than in past years and to accept more limited health plan options. The Cleveland District says union contracts were being renegotiated due to adverse economic conditions. Employers in the steel and aerospace industries have invoked "economic duress" clauses that exempt them from certain job-security provisions. Some of these renegotiations have involved wage concessions or agreements to postpone (with "give-back" provisions) scheduled wage increases.

Prices. Districts report declining prices for most goods and services with the notable exception of security, health care and medical, property and liability insurance. The Atlanta, Boston, Dallas, Minneapolis and New York Districts report steep increases in insurance costs.

Energy costs are lower and, as the Cleveland District notes, firms have reduced or eliminated energy surcharges. According to the Dallas District, warm weather and flagging demand led to declines in natural gas, crude oil and refined product prices. Forecasts of colder weather and collaboration between OPEC and non-OPEC producers to restrict crude oil production led prices to bounce back to just below mid-November levels. Inventories of most energy products, however, are significantly higher than a year ago.

FIRST DISTRICT – BOSTON

The First District economy remains slow but some brighter spots are visible. While revenues or orders are generally down from year-earlier, manufacturers note some signs of stabilization. And some firms, notably those making medical or security-related products, are seeing demand rise. Most retailers report a disappointing holiday sales season, although auto dealers and stores selling home-related products ended the year with sales gains. Residential real estate contacts concur that housing markets in the region are holding up well. While the consensus centers on a weak recovery beginning by mid-year, most contacts are very uncertain about its timing and strength and many are budgeting conservatively for a longer downturn.

Retail

Most contacted retailers report that sales during the October through December period were flat to declining compared with a year earlier. Respondents indicate that these results were somewhat worse than expected. Discount retailers, tourism agencies, and sellers of home and office furniture, computer and office technology products, office supplies, and art and architectural supplies report sluggish demand. Automobile sales are said to be up substantially, because of zero percent financing promotions. In addition, sectors related to the housing market (building materials and hardware) cite modest to strong growth in sales.

Employment levels and wage rates are mostly said to be holding steady. However, the tourism sector is still reducing employment. Selling prices are being discounted to boost sales, and most contacts report either steady or declining profit margins. Capital expansion plans of most retailers have been put on hold. The mood in the First District retail sector is downbeat; most retailers expect a weak turnaround starting in the third or fourth quarter of 2002. Contacts in tourism and discount retail are even more pessimistic; they expect bad times to last through all of 2002.

Manufacturing and Related Services

Most First District manufacturing contacts report that fourth quarter revenues or orders were down from a year ago. Sellers of machine tools, semiconductor equipment, and most aircraft equipment said that business remained depressed. By exception, demand increased relative to a year earlier for biotech products and medical devices, as well as for equipment related to national defense, air safety, and emergency back-up systems.

Despite the prevalence of year-over-year declines, manufacturers indicate that demand for consumer goods improved late in the fourth quarter. For example, several contacts report a recent pickup in orders for home appliances and furnishings, and a maker of automotive parts said that the fourth quarter did not turn out to be as bad as management had feared. Some of these firms attribute the improvement to temporary promotional activity.

Most makers of capital goods and other business products also see signs that business is stabilizing. However, they expect sales to remain weak in the first half of 2002 and to show only modest recovery in the second half.

Contacts report that selling prices and materials costs are flat or down. Sellers of machinery, equipment, information systems, and paper indicate that prices are falling because of competition and requests for discounts (especially on the part of customers in the airline, computer hardware, and financial services industries). Some respondents report that their aggressive supply management efforts have contributed to holding down costs. The only significant cost increases are for insurance, both health and property and casualty.

Manufacturers are budgeting conservatively for 2002. About one-half expect to implement further layoffs or furloughs, and an equal number are freezing pay for all or part of their workforces. The majority of respondents report that capital spending will be tight or reduced significantly. Several publicly held companies indicate that these actions are responses to external pressures to conserve cash.

Residential Real Estate

Residential real estate markets in New England continue to be active, although contacts note slowdowns in some areas. Massachusetts, New Hampshire, and Vermont respondents report that activity levels are lower than a year ago and houses stay on the market longer. However, Maine and Rhode Island contacts say they have not experienced a slowdown to date. Although inventory has increased throughout the region during the past few months, the buildup has been minimal and many areas continue to report an insufficient stock of houses on the market. Supply is now considered more closely aligned with demand, but not excessive. As the pace of activity has moderated, prices either have remained flat or have shown single-digit increases. Most contacts expect the first quarter to be slower than usual, but sales are expected to pick up again in the second quarter.

Insurance

Almost all contacts report strong sales and pricing at the end of 2001. Life insurance sales were strong in the fourth quarter and made up for some of the lost sales following September 11. Specifically, sales of term life insurance have risen in the last few months and application requests for traditional life have also increased. Disability insurance contacts report improving sales but also increases in the number of submitted and paid claims (signs of a weak economy). Property and casualty insurance providers had the most upbeat reports. Rates have increased by 15 to 20 percent from "severely underpriced" levels last year and are expected to continue to rise as more annual contracts are renewed. The one negative report came from a health insurance contact that announced major restructuring for 2002. The company's health plan membership is expected to fall sharply, in part because it is raising its membership premiums dramatically to match rising costs and pulling out of some unprofitable market segments where it cannot compete with local providers.

With the exception of the health insurance contact, insurance companies expect to hold capital spending and employment levels mostly flat in 2002. A couple of contacts mention a new focus on cutting costs by more fully utilizing technology already put in place. Generally, insurance respondents view 2002 with “guarded optimism.” Most expect the economy to begin to improve at mid-year.

SECOND DISTRICT--NEW YORK

Economic activity in the Second District has shown further signs of rebounding since the last report. Aside from steep increases in business insurance costs, price pressures remain subdued. Labor markets have recently shown signs of stabilizing. Retailers report that holiday-season sales—though, on average, little changed from a year earlier—were generally above plan, and appeared to be gaining momentum in late December and early January. Virtually all contacts describe inventories as lean. Most of the retailers surveyed report steep price discounting, and about half indicate that they hired fewer holiday workers than a year earlier.

Housing markets in most of the District have strengthened further since the last report, though Manhattan's rental market remains slack. Manhattan's office market appears to have stabilized in November and December, while suburban markets have softened further. Hotel occupancy rates continued to recover in November, but room rates were down 23 percent from a year earlier. Purchasing managers report sharp improvement in business conditions in the New York City area, but further weakness in the Buffalo area. Finally, bankers report stronger demand for home mortgages, ongoing tightening in credit standards, and little change in delinquency rates.

Consumer Spending

Retailers generally report that sales were above plan in December, although heavy discounting reduced profit margins. Compared with a year earlier, changes in same-store sales volume varied substantially: reports from general merchandise chains ranged from a 4 percent decline to a 6 percent rise, while discount chains and home-improvement retailers reported increases of 5-10 percent. All retail chains surveyed reported lean inventories at the start of the new year.

Most contacts report that sales strengthened substantially toward the end of the month, and remained strong in early January. Business at Manhattan stores improved noticeably in December but remained somewhat weaker than in the rest of the region. More generally, aggressive promotion and discounting were widely reported, though one major chain described the 2001 holiday season as somewhat less promotional than the prior year's. Similarly, based on a trade association's annual survey of small retailers across New York State, holiday sales were virtually unchanged from a year ago, while discounting was more pronounced than in 2000.

In general, retailers note that the strongest sales categories involved goods for the home—bed & bath, furniture, appliances, home improvement, appliances, and electronics. Most contacts also note fairly strong sales of women's apparel. In contrast, sales of men's clothing and luggage remained particularly sluggish.

About half of the retail chains contacted report a decline in holiday staffing, compared with 2000, while the rest indicate no change. Retailers report lower employee turnover and little or no wage pressure but continue to note sharp increases in health, property and other business insurance costs.

Construction and Real Estate

Commercial real estate markets in and around New York City generally remained slack at the end of 2001. Office vacancy rates in most of New York City's suburbs continued to rise in the fourth quarter. In Manhattan, however, there were some signs of stabilization—office availability rates leveled off in November and December in both Midtown and Lower Manhattan, though they were sharply higher than at the end of 2000. Asking rents have fallen roughly 10 percent over the past 12 months, and declines in actual contract rents have reportedly been more pronounced still. A local industry expert reports that Manhattan firms put a massive amount of extra space on the sublet market after September 11, and that almost all unused space is now on the market.

A leading New York City housing appraisal firm reports that co-op and condo sales activity recovered steadily in November and December but remained well below levels of a year earlier. Manhattan apartment prices are estimated to be down about 5-10 percent, on average, over the past 12 months, though there are still some reports of lower-priced units selling at above the asking price. The rental market has weakened more sharply, with rents reported to be down as much as 20 percent.

The single-family housing market has held up particularly well. Homebuilders in northern New Jersey indicate that a supply shortage is, once again, buoying home prices. Similarly, New Jersey's existing home market has reportedly snapped back, led by the moderately-priced segment. In New York

State, the market for existing homes remained strong in November: unit sales were roughly on par with a year earlier while prices were up nearly 6 percent, on average. Moderate price declines were recorded in the Rochester area and Westchester County, but New York City, Long Island and most of the Hudson Valley registered double-digit gains.

Other Business Activity

Unemployment insurance claims in New York City appear to have retreated to roughly pre-attack levels, after correcting for seasonal movements, by December. More recently, a major NYC employment agency reports that hiring seems to have picked up in early January, led by demand from smaller clients.

Manhattan hotels report that occupancy rates continued to recover in November and were down only 10 points from a year earlier. Hotels room rates edged up in November but were still 23 percent lower, on average, than a year earlier. While tourism from overseas is still described as weak, there has reportedly been a noticeable rebound in domestic visitors.

Surveys of purchasing managers across the District paint a mixed picture. Purchasers in the New York City area report a sharp snapback in business conditions in December, following widespread weakness in October and November. However, in a survey taken prior to the late-month snowstorm, Buffalo-area purchasing managers indicate a marked weakening in business conditions in December—widespread declines were reported in employment, new orders and especially production activity.

Most Buffalo-area businesses queried in early January report that the snowstorm caused partial or complete shut-downs on December 27 and 28; disruptions were widespread but generally short-lived. More generally, manufacturers across New York State report some pickup in general business conditions and new orders in late December and early January and express continued optimism about the near-term outlook.

Financial Developments

Bankers at small to medium-sized Second District banks reported mixed demand for loans over the past two months. Demand for residential mortgages increased, on balance, while demand for consumer loans registered a typical seasonal decrease; widespread increases in refinancing activity were again reported. On the supply side, credit standards tightened for all types of loans, with no bankers reporting an easing of standards. Most notably, 22 percent of bankers reported tightened standards for commercial and industrial loans, and 20 percent reported tightened standards for consumer loans. Both loan and deposit rates fell across the board since the last report. Delinquency rates were reported unchanged for all types of lending.

THIRD DISTRICT – PHILADELPHIA

Business conditions in the Third District remained slow in December, but there were a few positive signs. Manufacturers reported continuing declines in shipments and orders, but the rate of decline appeared to be easing. Sales of general merchandise at area stores for the Christmas shopping period increased a few percent over the prior year, slightly exceeding pessimistic forecasts. Auto sales fell in December compared to November but seemed to be holding steady in early January. Bank loan volumes increased in December in the major credit categories: business, consumer, and real estate.

The outlook in the Third District business community is cautious. Manufacturers predict an upturn by the middle of the year, and they have slightly raised capital spending plans for the first half of the year. Retailers are not certain that sales will continue moving up in the next few months, and they have generally modest sales targets for the first half of the year. Auto dealers anticipate nearly steady sales for most of this year at a slower rate than last year. Bank credit officers see some signs of modestly increasing demand for commercial and industrial loans, but they say the outlook for consumer lending is unclear and real estate lending could ease.

MANUFACTURING

Manufacturing activity in the Third District remained on a downward trend in December, but there were some indications that the rate of decline was easing. Compared with November, fewer firms reported decreases in orders and shipments, although business was weak in nearly all the major manufacturing sectors in the region. Firms producing metals and metal products continue to report that their customers are shifting to foreign suppliers. Firms producing electrical and electronic equipment indicated that continuing weakness in the telecommunications industry has been holding down demand for their products. A majority of the region's manufacturers maintained steady working hours in December, but around one-fourth made cuts, and only a few firms expanded hours. Area firms continued to reduce inventories, on balance.

Local manufacturers look for recovery to get under way by midyear. Just over half of the firms surveyed in December forecast increases in orders and shipments over the next six months. They also expect some firming in industrial prices. On balance, firms in the region have slightly increased their capital spending plans for the first two quarters of the year.

RETAIL

On balance, Third District retailers reported slightly higher sales for the recent Christmas shopping period compared to a year ago. Increases in sales in the last week of December and the first week of January provided many area retailers with the boost they needed to achieve year-over-year gains of around 2 percent, on average. Price reductions to stimulate sales were described as very deep by store executives, who expect low profits for the season. Retailers indicated that apparel sales were weak, especially for men's wear. Sales of outerwear were also quite slow, hampered by unseasonably mild weather during most of December. Sales of consumer electronics, jewelry, and home furnishings were better than most retailers had expected.

Cautious purchasing by stores prior to the holidays and aggressive discounting afterwards has generally left area retailers with acceptable inventory levels. Nevertheless, stores in the region are unlikely to significantly increase buying of spring merchandise. Most retailers have very modest sales targets for the first half of this year. They see no evidence that consumers will move to a higher pace of spending soon. Some even expect consumers to look for ways to economize further, at least for the next quarter or two, until general economic conditions improve.

Auto sales in the region fell in December from November, but sales in early January appeared to be steady at the December pace. Inventories were generally described as low. Dealers expect sales to fall as manufacturers' incentive-financing programs are scaled back, but they do not anticipate a continuing decline in demand. Rather, most of those contacted for this report anticipate a generally steady sales rate this year, albeit below last year's overall rate.

FINANCE

Lending at major Third District banks increased moderately in December. Outstanding loan volume has increased in all major credit categories—commercial, consumer, and real estate. Much of the increase in consumer lending was said to be seasonal. In contrast, the slight increase in business lending was seen as a potential trend by bank lending officers, who said low interest rates and anticipation of improving economic conditions have prompted some business borrowers to proceed with expansion plans. Concern about business credit quality persists, however, and several of the bankers contacted for this report said they are more strictly enforcing credit policies than they had been. Nevertheless, most banks in the region are still actively seeking to increase their commercial loans.

Bankers in the Third District expect business loan demand to move up, but not strongly. Overall gains in commercial and industrial loans will be limited by bankers' concern about extending credit to industries currently or potentially experiencing relatively weak conditions, such as travel, food service, health care, and construction. Bank lending officers are uncertain of the course of consumer and real estate lending, although many anticipate some easing in the growth of real estate loans after last year's large increase.

FOURTH DISTRICT – CLEVELAND

According to reports gathered the first week of January, the Fourth District economy still appeared to be in the process of bottoming-out during the last two weeks of November and the month of December. Some industries, however, did report improved business conditions: demand for construction services throughout the District remained unexpectedly strong, and manufacturing reported improvement in the northern part of the District, including expansion in the Cleveland metro area. Retail sales, on balance, were the same or a bit higher than a year earlier – an outcome that exceeded expectations. Contacts reported that unseasonably warm weather contributed to good auto sales, but resulted in poor winter apparel sales.

"Cautious optimism" characterizes the 2002 business outlook in the Fourth District. Most contacts expect a flat first quarter, with recovery beginning late in the second quarter 2002 or very early in the third quarter.

Labor markets continue to struggle. Demand for temporary workers slowed in December, and job security remained the number-one concern among unionized workers. While, on average, wage adjustments in new contracts remained fairly constant over the last two months, several contacts reported renegotiations due to adverse economic conditions. Employers in the steel and aerospace industries have invoked "economic duress" clauses that exempt them from certain job-security provisions. Some of these renegotiations have involved wage concessions or agreements to postpone (with "give-back" provisions) scheduled wage increases. Our contacts continued to report increasing health care and benefits costs.

Manufacturing

The manufacturing outlook continues to improve for the northern part of the District. Contacts reported industry expansion for the second consecutive month in December for Northeast Ohio. In the southern part of the District, manufacturing reports were mixed: While employment remained fairly constant, inventories and prices declined. Overall, new orders and production declined in December, but the number of manufacturers reporting increases in new orders rose from November to December.

Both the auto and steel industries reported mixed conditions. Some auto plants in the District worked overtime hours to meet booming demand for their models, while others were forced to close for two weeks because of slumping sales of the models produced at those plants. In the steel industry, prices remained steady (with no expectation of decline), and some contacts reported that they would attempt price increases during the first quarter. While some steelmakers reported very modest improvement in conditions during the fourth quarter, most reported that business was flat from the previous quarter. Most contacts still expect conditions to improve late in the second quarter or early in the third quarter 2002.

Retail Sales

Although retailers reported weak activity through most of December, many noted that activity was strong in the days immediately preceding and following Christmas. Contacts noted that after-Christmas discounts and promotions were not significantly different from those in previous years. Overall, retail sales for the holiday season beat expectations, and sales were about the same, if not slightly better, than sales for the same period in 2000. Individual segments of the retail sector, however, had widely differing reports: Discount retailers noted that holiday sales were up 4-8 percent year-over-year, while apparel retailers reported their sales were down 3-9 percent year-over-year for the same six weeks. All contacts blamed weak winter apparel sales on unseasonably warm weather in the District. In general, contacts expect retail sales for the first half of 2002 to be flat or slightly better than the first half 2001, followed by marked improvement in sales for the second half of the year.

Auto dealers reported that sales the last half of November and December slowed from the record pace seen in October (when most contacts reported monthly sales roughly 40 percent above those in October 2000), but they noted that, despite the recession, December sales were still around the historical average for the month. On average, contacts expect poor first-quarter sales for two reasons. First, manufacturer offers for zero-percent financing and cash back on specific models will expire in January. Second, seasonality and higher-than-expected sales during the final quarter of 2001 will lower demand. Most dealers expect sales to rebound during the second or third quarter 2002.

Construction

Conditions in the construction industry continued to improve in late November and through December. Although the industry typically sees a slowdown during the holiday season, this was not observed this year. Most contacts reported that customer interest in initiating new projects was "uncharacteristically strong." Building activity has remained steady in both the commercial and residential sectors. The costs of labor and materials remained steady.

Some builders reported that increasing interest rates appear to have compelled some buyers to act out of concern that if they did not take advantage of lower rates now, the opportunity might not exist later. Others voiced concern that the rising interest rate environment might adversely affect demand, but, on balance, District builders remain cautiously optimistic about their prospects for 2002.

Trucking and Shipping

Trucking and shipping activity declined in December relative to October and November, but most of the decrease was seasonal (because Christmas fell on a Tuesday, manufacturer holiday shut-downs were slightly longer than usual, which also contributed to lower figures for December). Shipping of retail goods was slightly stronger than expected, but shipping activity for manufactured and manufacturing-related goods continued to decline. Overall shipping activity was down approximately 10 percent year-over-year for the fourth quarter. Contacts reported that total shipping volume throughout 2001 was well below prior-year figures.

Initial reports suggest that shipping activity the first six weeks of 2002 will remain steady from the last six weeks of 2001. Although carriers expect activity for January and the first half of February to be slow (in part due to seasonality), contacts are cautiously optimistic about the last half of the year. Most contacts expect turnaround in their industry late in the second quarter or early in the third.

With the exception of a recent slight uptick, diesel prices declined throughout late November and December. Surcharges associated with energy are currently very low, and some contacts reported that they have eliminated these surcharges.

Banking

Competition for borrowers continued to be very aggressive across all lines of lending as the demand for commercial and consumer loans remained soft. Most contacts reported that applications for loans were holding steady, but one contact did report an increase in applications. Banks reported that the credit quality of loan applicants had diminished. Roughly half our contacts reported an increase in the rate for loan delinquencies, while the other half reported a decrease.

Mortgage refinancing activity remained strong, although contacts did note some decline in activity during the second half of December as interest rates began increasing. Demand for auto loans at district banks remained low, as manufacturers continued to offer zero-percent financing.

FIFTH DISTRICT–RICHMOND

Overview: Fifth District economic activity was mixed from late November through early January. Declines in manufacturing output and retail sales accompanied moderate growth in service firms' revenues. Manufacturers reported substantially lower shipments and new orders in December, and a snowstorm in early January caused some manufacturers to curtail their operations for a day or two. Nevertheless, manufacturers remained optimistic about their prospects for the next six months. In retail, holiday sales were slightly below year-ago levels and retailers said that unusually large price discounts were needed to move merchandise. Stronger conditions emerged in the service sector as revenues at services firms rose solidly in December. In real estate, residential and commercial realtors reported little change in sales and leasing activity, while bankers said that higher interest rates damped residential mortgage refinancings. Employment continued to fall at District factories in December, but temporary employment agencies reported somewhat stronger demand for most categories of workers. In agriculture, rain and snow in recent weeks helped replenish depleted soil moisture levels and improved the conditions of small grain crops.

Retail: Seasonally-adjusted retail sales were moderately lower and shopper traffic was relatively light in District stores since our last report. Contacts at hardware and building supply stores in Richmond, Va., and Columbia, S.C., for example, said that sales were subdued. A big-box retailer in the Tidewater area of Virginia experienced flat revenues, and sales were slightly lower for a discounter in southeastern West Virginia. A manager at an upscale department store with locations throughout the District said weak demand led them to lower merchandise orders in an attempt to reduce inventories. Holiday price discounting was intense. A contact at a large Charleston, S.C., department store reported that unusually large discounts were necessary during the holidays to entice customers to buy. Big-ticket sales were flat in November and December and automobile sales were mixed as manufacturers' incentives trailed off.

Services: Demand picked up for many District services firms in November and December. A contact at a catering firm in Charleston, W.V., said a solid local economy resulted in strong holiday business and higher orders for the coming year, while a West Virginia-based web designer reported stepped-up demand for his services. A fundraising firm in Charlotte, N.C., described increased success in raising money for the arts and other local charitable organizations. Additionally, businesses that offer security and other anti-terrorism related services cited a pickup in demand. Healthcare industry contacts reported generally steady demand for their services, but two North Carolina contacts said they were seeing increased competition for nurses, with bonus offers and "wage wars" common.

Manufacturing: Activity in the manufacturing sector continued to contract in December and early January. Compared to prior months, shipments declined at a faster pace although new orders fell at a somewhat slower rate. Textile manufacturers reported generally weak demand for their products and continued intense competition from foreign producers. Additional bankruptcies were reported, most notably by a large textile firm headquartered in Greensboro, N.C. Chemical and primary metal manufacturers reported declines both in their shipments and new orders in December. In early January, a winter storm disrupted manufacturing activity. A number of manufacturing plants shut down operations for one or two days and some plants could not ship products or receive raw materials because of the poor road conditions. Most of these manufacturers, however, indicated that lost output was made up within several days, although overtime pay and additional utilities expenses were incurred in some instances. Both manufacturing employment and the average workweek declined in December, while wages rose modestly and prices were mostly flat.

In spite of the recent softening in activity, Fifth District manufacturers were more optimistic regarding their prospects for the first half of 2002. Respondents anticipated that shipments, new orders, and capital expenditures would increase substantially by mid-year.

Finance: District loan officers reported that since our last report, higher mortgage interest rates constrained residential lending, while weak demand continued to hamper commercial lending. Residential mortgage lenders noted that refinancing activity fell steeply in December, although loans for house purchases have been resilient in most areas of the District. Commercial lenders said that many of their clients had curtailed business expansion plans and were waiting for a turnaround in their businesses before committing to further borrowing. A Richmond, Va., banker said that lending activity was focused on loans "already in the pipeline," rather than new loans initiated in recent weeks. Several commercial lenders, however, said that they expected a pickup in lending activity by the second quarter of 2002 since many of their clients expected healthier business growth by that time.

Real Estate: Residential realtors and homebuilders reported little change in home sales since our last report. Several contacts noted that sales of higher-priced homes slowed while sales of moderately-priced homes held steady. A realtor in Greensboro, N.C., noted a decline in sales of upper-end homes in that area and said that job insecurity in the wake of the bankruptcy filing by a local textile firm was still depressing the housing market. But a brighter note was sounded by a realtor in southern Maryland who said that sales activity across all price ranges had increased "incredibly" in recent weeks. His agency was so busy on New Year's Eve that he wondered why prospective clients were calling him and not "out partying." Several homebuilders in North Carolina reported lower lumber prices, but construction labor costs were generally stable.

Commercial realtors across the District reported little change in leasing and construction activity in recent weeks. Leasing activity in the office and industrial sectors remained subdued, while the leasing of retail space increased only slightly. Rents continued to move lower for the office and industrial markets, but stabilized in the retail market—a realtor in Greensboro, N.C., described current rent levels as "more realistic." Vacancy rates across all sectors continued to rise, but at a slower pace in recent months. New construction activity was generally flat across the District.

Tourism: Tourism activity was mixed in December and early January. Contacts at several District ski resorts reported that the ski season opened about three weeks behind schedule due to an unseasonably warm December. A manager at a ski resort in Virginia said that bookings were down about 50 percent from last year. He noted, however, that patronage picked up considerably during the week between Christmas and New Year's Day. A contact at a West Virginia ski resort told us that advance reservations were also trending higher, in part because of colder weather and lower gasoline prices. Tourism in coastal areas was somewhat stronger than we last reported. A contact on the Outer Banks of North Carolina noted that concerns with airline safety had boosted tourism in the area.

Temporary Employment: Contacts at temporary employment agencies reported somewhat stronger demand for workers since our last report. Demand was notably higher for light industrial and warehouse workers and for call center employees. Most temporary agency managers reported little change in wages, although a Rockville, Md., agent noted that, in order to get work, some temporary employees were willing to accept slightly lower wages. A number of contacts said they expected demand for temporary workers to pick up over the next six months, in part because some clients were now moving ahead with projects that had been put on hold.

Agriculture: The dry weather that had persisted in recent months ended in December as rain showers fell across most of the District. In addition, a snowstorm moved up the East Coast in early January, covering much of the Fifth District with sleet and snow. The much-needed precipitation boosted small grain conditions and helped restore soil moisture levels in deteriorating pastures. With the 2001 harvests complete, District agricultural bankers say that bumper crops helped the financial condition of many farm customers, but they noted that low crop prices continue to leave some financially vulnerable.

SIXTH DISTRICT – ATLANTA

Summary: Economic conditions in the Southeast were mixed during December and early January. According to contacts, retail sales were mediocre, and vehicle sales declined for some makes and models. Residential real estate markets remained solid, but weakness in commercial real estate markets persisted. The manufacturing sector also remained weak, but there were indications of a modest pickup in orders for some industries and more stability in employment levels. Bank loan activity was still concentrated in the consumer sector, although a modest increase in demand for financing of mergers and acquisitions was noted. Travel activity improved further from the lows experienced after September 11, but hotel occupancy was still below normal. An early January snowstorm temporarily disrupted economic activity in parts of the District. Inflation indicators were mostly subdued.

Consumer Spending: Deep discounting was widespread during the holiday season as retailers struggled to make sales. Sales results were mixed across product types, and discount stores continued to fare better than other types of retailers. Apparel sales were difficult because of unusually mild weather in early December. Sales of home electronic and other home-related products were generally strong. According to contacts, post-holiday traffic was down compared with recent years, although some also noted that the amount of clearance merchandise available was also lower.

December vehicle sales were mixed. Car sales were reported to have declined sharply for some makes and models, but there were gains in light truck segments and for popular SUV models. Meanwhile, used car dealers reported large inventories and weak prices.

Real Estate and Construction: The District's single-family home markets continued to perform well in December. The demand for low- to mid-priced homes was strong, while the demand for high-priced homes remained soft in several markets. Contacts suggested that home sales may have equaled or surpassed year-ago levels in December, while the pace of new home construction was near the level of a year ago.

Commercial real estate markets have changed little since our last report, with conditions remaining weak in most areas. Vacancy rates increased in some markets, and the increasing abundance of sublease space across the District kept absorption low. Construction levels have slowed considerably over the year, and current commercial construction is dominated by build-to-suit and government projects.

Manufacturing: Factory activity remained weak in December, and further job cuts were announced in several industries. Some companies reported reductions in part-time workers and the elimination of extra shifts. However, reports were also more mixed than in recent months. Several firms noted a modest pickup in new orders and were rehiring some of their recently laid-off staff. Also, while one large auto manufacturer was considering cutting capacity at a District assembly plant, some other auto producers in the District were working overtime to keep up with demand. The District's defense contractors continued to benefit from contracts for a variety of projects, and a producer of health-care products announced plans to expand capacity because of continued strong demand.

Tourism and Business Travel: Travel activity continued to improve in December from the lows experienced following September 11, but hotel occupancy was still below normal in several locations. In south Florida, occupancies remained held down by the decline in international tourists. The size of the price discounting for hotel rooms, cruises, and rental cars has lessened in markets where traffic has nudged higher. Activity at Mississippi Gulf Coast casinos remained solid. The New Orleans economy will benefit from hosting the Super Bowl in early February, and early bookings for the Carnival season are encouraging. An unexpectedly severe snowstorm in parts of the District in early January disrupted travel activity.

Financial: Loan activity remained mixed. The consumer sector was robust in most parts of the District. Refinancing and home equity loan activity was "booming," according to some contacts. Delinquency rates on consumer loans continued to increase but remained at low levels overall. Commercial loan demand remained soft, but banks reported some increase in merger and acquisition activity in the District.

Wages and Prices: Wage and price pressures were subdued in the District. According to some reports, the size of year-end bonuses or pay increases for salaried workers was lower than in recent years. Hospitals continued to hire aggressively and offer large signing bonuses. Reports again suggested that recent price increases have been limited to health-care costs, security costs, and insurance premiums. Home price increases continued to moderate, while previous sharp declines in prices for hotel accommodations and other travel-related services abated in areas where demand has recovered. Low energy prices continued to moderate gas and oil extraction activity in Louisiana.

Agriculture: Crop producers in the District remain pressured by low market prices. Prices were well below year-ago levels for cotton, soybeans, and peanuts. However, lower crop prices have helped reduce feed costs for the District's large poultry industry as well as cattle producers. Early indications suggest that the 2001 sugar harvest will fall short of last year because of recent drought conditions, but prices for Florida's citrus products continued to improve on reports of weaker growing conditions in Brazil.

SEVENTH DISTRICT—CHICAGO

Summary. Economic activity in the Seventh District was again soft in December and early January, with scattered reports of improvement in a few sectors. Most retailers failed to meet their holiday sales goals, despite heavy discounting and extended shopping hours. Residential construction and real estate activity picked up somewhat toward the end of 2001, while softness in the nonresidential segment persisted. Despite progress in working down inventories, industrial production remained weak in the District. Overall loan demand softened toward the end of the year as higher mortgage interest rates put a damper on new mortgage refinancing activity, and business borrowers stayed on the sidelines. Labor markets were relatively weak, but the rate of job losses appeared to be waning in some areas. Upward pressure on wages and prices continued to ease due to the general economic slowdown.

Consumer spending. Overall consumer spending remained relatively soft in December and early January. Holiday sales failed to meet most retailers' expectations, despite extended shopping hours and heavy discounting that began earlier in the season. According to some national retail chains, as well as national casual dining chains, sales results in the Midwest were weaker than in most other regions. Many contacts reported that sales picked up noticeably in the days immediately before and after Christmas day, but not enough to overcome softer sales earlier in the period. However, electronics and home-related items were said to have sold well. Winter apparel sales were hampered for most of December by unseasonably warm weather, but did pick up with large discounts and colder temperatures in late December and early January. Businesses dependent on winter sports also suffered as a result of the relatively warm temperatures, as well as a lack of snow. Light vehicle sales in the District slowed modestly from November to December, but remained seasonally strong as a result of steady advertising and generous consumer incentives. Overall retail inventories were reported to be in good shape, as many retailers had already planned for softer holiday sales, but new light vehicle inventories continued to be quite low. One airline contact noted that flights were fuller than expected over the holidays, and the company had recently added marginally to its capacity. There were few reports of intensifying upward pressure on prices and, in fact, one contact reported that a price increase sparked many more complaints than in previous years.

Construction/real estate. Construction and real estate reports were mixed as 2001 drew to a close, as residential activity remained fairly robust while nonresidential activity continued to weaken.

Sales of both new and existing homes were said to be relatively strong, largely due to favorable interest rates. While fixed-rate mortgage interest rates increased modestly from recent lows, many contacts indicated that home sales continued to show improvement from the effects of September 11. Some realtors and builders suggested that December's sales results may have equaled the previous December, after several months of decreases in year-ago comparisons. First-time-buyer homes sold briskly while luxury homes continued to languish on the market. Likewise, price appreciation was said to be stronger at the lower end of the market than at the upper end. Many contacts suggested that the confidence of potential home buyers continued to recover from the effects of September 11, and expected 2002 to be a very good sales year. Nonresidential activity remained sluggish in December and early January. Office vacancy rates continued to rise, putting further downward pressure on rent rates. In addition, landlords were said to be increasingly willing to offer concessions such as more generous tenant improvement packages. A commercial realtor in one large metro area, however, reported a significant increase in the number of "lookers" coming through office buildings since Thanksgiving. The market for light industrial and retail space was reportedly steady but soft, and retail vacancies were increasing in some areas. Construction of infrastructure projects was reportedly softening in some areas as well.

Manufacturing. Overall manufacturing activity remained weak at the end of 2001, but there were scattered signs of modest improvement in some industries. Largely due to extraordinary incentives, nationwide light vehicle sales exceeded manufacturers' expectations again in December, despite softening from November. As inventories remained very lean, one manufacturer indicated that its light vehicle production in the first quarter of 2002 would be 6 percent to 7 percent higher than a year earlier. Steel production picked up in the last week of December and prices reportedly increased modestly from very low levels. With inventories said to be well below desired levels at both mills and service centers, one industry contact stated that "the reduction in steel inventories is over." Prices of gypsum wallboard continued to move up from very low levels, but were flat with a year ago. One industry contact forecast that wallboard shipments would be down 5 percent to 10 percent in 2002, adding that 2001 was the second best year ever for the industry. Conditions in heavy equipment industries (including heavy trucks) remained very weak, and most manufacturers of heavy equipment cut their forecasts for 2002. Noting that retail sales of equipment were no longer falling, however, one industry contact said that the bottom of the downturn was near. A machine tool producer in the District said that "things are getting better every day," and this firm had begun to hire new workers.

Banking/finance. Bankers' reports on lending activity were mixed. Household borrowing remained strong, but tapered off in December as long-term interest rates rose. Some banks reported record volumes of mortgage refinancing closings in December, although the number of deals in the pipeline fell off during the month. Standards and terms for household loans were largely unchanged and credit quality was said to be holding steady to improving slightly. Reports on business lending activity were mixed, but generally indicated continued softness. Most lenders noted little or no pickup in demand beyond normal seasonal variations. One large bank, however, reported that business loan volumes were up about 6 percent in December in year-ago comparisons, after being flat for most of 2001. There were a few reports from bankers of further tightening of standards for loans to firms in industries that have been hit hard by the general economic slowdown, such as tourism and travel. At the same time, the number of small businesses complaining of a lack of access to credit became more frequent, with one contact noting that "some firms cannot get operating credit even though they are profitable." There was little further deterioration in overall business loan quality reported, although one lender said "we will be holding our breath for the next six months."

Labor markets. Labor markets remained soft in December and early January, although there were some signs that they may be stabilizing in some areas. Year-over-year growth in initial unemployment insurance claims in District states fell to near zero in late December, after being as high as 80 percent earlier in 2001. However, continuing claims remained high and there were several reports indicating that many workers were still out of a job. A large District auto group noted that resumes from workers seeking office jobs were very high in recent weeks and a large realty firm indicated that new realtor classes were "exceptionally large" in November and December. Some state analysts said they did not see the typical seasonal "bump" in retail employment and contacts in casual dining suggested that workers were "easy to find." Layoff announcements from manufacturers became less frequent and some companies actually reported new hiring. With persistent softness in labor markets, upward wage pressures continued to abate. Contacts from a wide variety of industries indicated that wage increases had fallen from mid-single digits early in 2001 to low single digits by the end of the year.

Eighth District - St. Louis

Summary

Economic activity in the District continues to be weak, particularly in the manufacturing sector. A small number of manufacturing industries, however, have begun to recover. Retail holiday sales were about the same as last year's and were buoyed by promotions and extended store hours. The residential real estate sector remains relatively strong, although weakness continues in some parts of the District. New housing permits continue to be issued at higher level than a year earlier. Commercial real estate markets have continued to be stagnant throughout the District, although commercial construction has been expanding in some areas. Credit standards for commercial loans have been tightening, particularly for commercial real estate loans. Deposits at banks rose through the fourth quarter along with mortgage volume and mortgage delinquencies.

Manufacturing and Other Business Activity

The District's manufacturing sector continues to be weak, as reports are dominated by announcements of closings, consolidations, and cutbacks. Affected industries include steel, automotive and tire, furniture, fabrics, tools, electrical products, oil and gas, and aluminum. Most contacts report difficulty maintaining profit levels, which they attribute to declining orders. Nonetheless, some firms in the food, appliance, cardboard, garment, and plastics industries are experiencing expansion and recovery.

The District's holiday sales were slightly below expectations, although in line with sales for the same period last year. Numerous retailers used holiday promotions and longer store hours to lure customers. Apparel, toys, and jewelry were slow movers, while music, video, and home entertainment products have sold well. Travel and logistics companies are still recovering from the demand reductions following September 11th, while sales for grocery stores, hair salons, and dry-cleaning services remain steady. Despite the weakness in retail sales, one major retailer in the District has announced an aggressive expansion that includes the addition of several stores.

Real Estate and Construction

Spurred by lower mortgage rates, home sales across large parts of the District continued to be strong in the fourth quarter. New homes continue to sell well in Arkansas, where October year-to-date unit sales and volume sales were higher than a year earlier. Contacts report a similar experience in October for Memphis, along with a record November for Evansville. On the other hand, sales of homes in the \$125,000-to-\$250,000 range remain slow in northern Mississippi, where inventories continue to grow. In Memphis, the market for office real estate had a net positive absorption rate for the third quarter of 2001, as it had for the previous quarter. In St. Louis, vacancy rates for bulk space, service center space, and office/warehouse space ended the year higher than they were at the beginning of 2001.

Residential construction opportunities remain strong in most of the District, as November year-to-date permit levels were higher than a year earlier. Commercial construction opportunities have begun to expand in parts of the District. For example, several companies have announced plans to construct manufacturing and production facilities in western Kentucky and southern Illinois. Also, state and local governments in Kentucky and southern Indiana have awarded infrastructure contracts for highways, bridges, and water treatment facilities.

Banking and Finance

A recent survey of senior loan officers at a sample of District banks revealed somewhat tighter standards for commercial and industrial (C&I) loans in the last three months. Contacts report that demand for C&I loans and consumer loans has become moderately weaker due to lower customer financing needs. Internal credit ratings for C&I loans, however, were largely unchanged, as were standards for residential mortgages, consumer loans, and credit cards. In contrast, 60 percent of contacts report a slight tightening of credit standards for commercial real estate loans.

According to contacts, demand deposits and time deposits increased moderately between October and December, while mortgage volume rose following reductions in interest rates. Contacts at local banks in Louisville report increased provisions for loan losses due to an increase in the number of mortgage delinquencies.

Agriculture and Natural Resources

While it is too early to know for certain, the District's dormant winter wheat crop may have been damaged by substantial rain in mid-December followed by frigid temperatures and the absence of a protective snow cover in late December and early January. Following a larger-than-expected crop, cotton prices fell by about 11 percent between late November and early January. Also, contacts remain uncertain about the potential impact that the temporary suspension of the Step II cotton subsidy program will have on exports. In conjunction with the economic slowdown, cattle and hog prices have fallen over the last three months, thereby squeezing profit margins. Reports indicate, however, that profit margins have been boosted by the lower price of nitrogen fertilizer compared with last year, as the price of natural gas—a major cost component in the production of nitrogen-based fertilizer—fell by approximately 75 percent over the period.

NINTH DISTRICT—MINNEAPOLIS

Economic activity in the Ninth District over recent months has been somewhat mixed. Commercial construction has slowed while residential construction is up slightly. While consumer spending has grown, manufacturing, agriculture, tourism, energy and mining are either mixed or down slightly. Meanwhile, from mid-November to early January, labor markets weakened and overall wages and prices are stable. However, decreases in heating costs and increases in health insurance rates were noted.

Construction and Real Estate

Commercial construction activity is down. Contracts awarded for heavy construction projects in Minnesota and the Dakotas decreased 10 percent during the three-month period ending in December compared with last year. The construction of an extended-stay hotel and an upscale condominium project were both recently suspended in the Minneapolis area due to uncertainties caused by the Sept. 11 attacks. An architectural firm in Minnesota noted decreased interest in private building construction for 2002. According to a commercial real estate representative, recent retail store openings and renovations in the Minneapolis/St. Paul area are at lower levels than a year ago.

Residential construction and sales are up from a year earlier. Bank directors noted that recent homebuilding and home sales are solid in many parts of the district. Rochester, Minn., recorded the second-biggest November for the number of home permits issued. Home sales in Minneapolis-St. Paul were up 23 percent in November and housing permits issued were up 7 percent in December compared with a year earlier.

Consumer Spending and Tourism

Holiday sales were generally higher at several district malls; however, some clothing stores and shopping centers reported soft sales. Managers and storeowners at three Montana malls reported solid holiday sales. A representative of a Minneapolis area mall estimated holiday sales were up 5 percent compared with a year ago, while another Minneapolis area mall reported traffic up over 10 percent. A North Dakota mall reported generally strong holiday sales with some softness in apparel compared with last year. Retail sales at restaurants and stores were strong during the week following Christmas, according to a chamber of commerce official in northwestern Wisconsin.

However, a manager of a Minneapolis area mall reported sales were down 3 percent in December compared with a year earlier. A department store manager in Duluth, Minn., reported flat holiday sales compared with last year. Winter attire sales during the holidays were slow due to warm weather, according to a clothing store owner in Minnesota.

While auto sales were strong in October and November, a bank director noted that sales slowed during early December. An auto dealer association representative in Minnesota reported that sales of new cars were softer in December compared with the previous two months, while inventories of used cars were up due to a high number of trade-ins during October and November.

Low snowfall levels have decreased winter tourism in several areas. Snowmobile trails remained ungroomed as of early January in northwestern Wisconsin and several lodging establishments there reported lower revenues in December compared with past years. In contrast, a ski resort in northern Minnesota reported solid numbers of skiers in December, while January bookings are ahead of last year. A Montana ski resort reports strong activity due to favorable snow conditions in December; however, advanced bookings for the rest of the season are down compared with last year.

Manufacturing

Overall manufacturing activity is down. A December survey of purchasing managers by Creighton University indicated decreases in manufacturing activity in Minnesota and South Dakota and increased activity in North Dakota. In Minnesota, a cabinetmaker and plastics producer both announced factory closings, while a bus manufacturer plans to cut production. In addition, a circuit board plant will be closed in western Wisconsin and a grain equipment factory in South Dakota will shut down.

Mining and Energy

Activity in the energy and mining sectors is down somewhat. Late December district oil and natural gas exploration levels are slightly behind the levels of mid-November. Meanwhile, an iron ore mine in the Upper Peninsula of Michigan and a mine in Northern Minnesota both extended a shutdown, while another mine in Northern Minnesota ended an eight-week shutdown in December, but at reduced production levels. In contrast, December production at a Montana palladium/platinum mine was about even with November levels.

Agriculture

Overall agricultural activity is mixed. Early January futures prices for most district agricultural commodities were little changed from late November. Meanwhile, mild winter conditions across most parts of the district have aided livestock production, but lack of adequate snow cover has concerned winter wheat growers.

Employment, Wages and Prices

Labor markets are softer than last reported as several firms have announced layoffs. A Minnesota-based airline carrier recently shut down its operations, which left 900 employees jobless. A financial services company will eliminate 400 positions in Minnesota. A commercial insurer will eliminate 250 positions at its St. Paul headquarters. A survey by a major temporary staffing agency showed that only 12 percent of firms polled in Minneapolis-St. Paul are planning to add staff during first quarter 2002, down from 34 percent in last year's survey.

Initial claims for unemployment insurance in Minnesota for the four-week period ending December 15 were up 38 percent compared with a year ago. According to results of the Minneapolis Fed's annual business conditions survey (conducted in November), only 15 percent of respondents expect employment levels to increase at their companies in 2002, down from 30 percent in last year's survey. However, several medical centers in the district continue to report difficulty filling positions for nurses.

Wage increases are modest. Only 5 percent of respondents to a survey of manufacturers in Minnesota, Wisconsin and the Dakotas reported increased wages in December compared with 48 percent a year ago. Wages for district manufacturing workers increased 2.2 percent for the three-month period ending in November compared with a year ago, the smallest year-over-year increase in almost three years. Bank directors expect wages to increase no more than 2 percent to 4 percent in 2002.

Price increases are moderate, with significant price decreases noted in winter heating and increases in health insurance rates. About 22 percent of respondents to a survey of manufacturers in Minnesota, Wisconsin and the Dakotas reported higher product prices in December, down from 40 percent a year ago. Recent natural gas prices for residential customers are down 35 percent to 50 percent in many parts of the district compared with last year. Bank directors reported significantly higher health insurance rates in their areas.

TENTH DISTRICT - KANSAS CITY

Overview. The Tenth District economy remained relatively weak in December and early January. Manufacturing activity declined further, construction and real estate markets eased, and energy activity continued to fall. Holiday retail sales, however, were slightly higher than a year ago in much of the district, and tourism activity in Colorado was especially strong over the holidays. In the farm economy, concerns spread about dry conditions throughout the district. District labor market conditions were similar to the previous survey, with most firms having few difficulties hiring workers. Wage pressures were virtually nonexistent, and there were some reports of wage and benefit cuts. Retail prices fell slightly with heavy holiday discounting, while prices for most manufacturing and construction materials were unchanged.

Consumer Spending. Holiday retail sales held up better than many retailers had feared, with most stores reporting slight increases from a year ago. Large discount stores continued to enjoy stronger sales than luxury retailers, and home furnishing items sold particularly well. According to some retailers, the solid holiday sales were due to heavy discounting and are unlikely to continue. Other stores predict steady sales activity through the spring. Most managers were satisfied with inventory levels after the holidays. District sources reported that traffic at ski resorts in Colorado was especially strong over the holiday season, as snow levels increased in late December. Motor vehicle sales in the district fell slightly from a very strong November, but were still well above year-ago levels due to attractive financing packages. Most of these incentives ended with the new year, however, and dealers expect overall vehicle sales to weaken considerably in coming months. The strong sales of new cars in recent months have produced an abundance of late-model used vehicles on dealer lots.

Manufacturing. District factory activity weakened further in December. A higher percentage of firms reported year-over-year declines in production, shipments, and new orders than in the previous survey. A large number of manufacturers continued to shed workers from their payrolls, and capital spending remained well below year-ago levels. On a positive note, however, a higher percentage of plant managers expected future increases in production than in previous surveys. Most manufacturers continued to trim inventories, but many expect inventory levels to stabilize in coming months. No significant shortages of materials were reported, and supplier delivery times remained largely unchanged.

Real Estate and Construction. Residential construction activity was down slightly in December, and commercial real estate markets remained weak. Home sales and housing starts were especially sluggish in Colorado, which has been hit hard by recent layoffs. Residential sales and starts in the rest of the district were mixed, with little activity occurring over the holidays. Sales remained weaker for high-end homes than for other types of homes. Commercial realtors continued to report weakness in district office markets. Construction starts have slowed significantly, coming to a virtual standstill in some areas. However, completed projects continue to come online, pushing vacancy rates up further. The surplus of office space was cited as being particularly problematic in Denver and Kansas City. In Denver, rent and tenant improvement concessions from landlords were said to be masking the full extent of rent declines in the local commercial market.

Banking. Bankers report that loans decreased and deposits increased since the last survey, reducing loan-deposit ratios. Demand fell for commercial and industrial loans, residential construction loans, and commercial real estate loans. Demand for home mortgages also eased, with a number of bankers reporting a dropoff in refinancing activity. On the deposit side, demand deposits, NOW accounts, and money market deposit accounts all increased. All respondent banks reduced their prime lending rates, but most banks left their consumer lending rates unchanged. Lending standards were generally unchanged.

Energy. Energy activity in the district continued to ease in December and early January. The region's count of active oil and gas drilling rigs reached a two-year low, as continued warm weather and the slowdown in the economy constrained energy prices. However, district sources expect prices and activity to ramp back up in 2002. Several district firms also reported expansion of coal-bed methane exploration activity into previously untapped portions of the district.

Agriculture. Concerns about dry weather persisted across agricultural areas of the district. There was little or no snow cover to protect the winter wheat crop from extreme cold temperatures, and lack of moisture has caused some signs of deterioration in the crop. Dry weather has also limited pasture growth, causing most ranchers to be reluctant to expand their cattle herds. District bankers report that some weakness in farm loan portfolios may surface during year-end credit reviews but that government payments to crop producers and strong livestock profits in the first half of 2001 will likely provide stability.

Wages and Prices. District labor market conditions remained similar to the previous survey, with firms continuing to report few difficulties hiring workers. The pace of layoffs rose slightly in December after slowing in November, but there were also reports that some companies that had put off adding workers after September 11 were beginning to hire again. Shortages also persisted for several specific occupations, including nurses, pharmacists, and some skilled building trades. There was virtually no evidence of wage pressures outside these occupations. In fact, several firms have cut wages and others have offered smaller merit pay increases than in the past. Some employers have also increased employees' share of health care costs. Most firms reported relatively few complaints from workers about these changes. Retail prices fell slightly due to heavy holiday discounting, but are expected to return to previous levels in the near future. Prices increased for some manufacturing materials, while prices for many petroleum-related materials eased. Some plant managers expect increases in material prices in coming months. Prices for construction materials remained largely unchanged.

ELEVENTH DISTRICT—DALLAS

Eleventh District economic activity continued to decline in late-November and December, but contacts were generally more upbeat about the outlook than six weeks ago. Many contacts remain cautious about the outlook and do not expect much improvement until the second quarter at the earliest. Manufacturing activity was flat or slightly down. Business service firms say activity suggests the economy is faltering, and the airline industry continues to suffer from weak demand and soaring security costs. A burst of sales around Christmas helped many retailers meet their expectations for the season, although discounting was very heavy. Contacts at financial institutions say loan demand remains flat, and there have been no reported changes to delinquency rates. Construction and real estate activity continued to weaken, and the energy industry continued to decline. There was little change in agricultural conditions.

Prices and Labor Markets. Price reports were mostly unchanged or lower. Warm weather and flagging demand led to declines in natural gas, refined product and crude oil prices in late November and early December. Forecasts of colder weather and collaboration between OPEC and non-OPEC oil producers to restrict crude oil production led prices to bounce back just below mid-November levels. Inventories of distillates, heating oil and diesel are twenty million barrels higher than last year. Natural gas inventories built to 3.1 trillion cubic feet in storage due to warm November weather. With 45 percent of the heating season behind us, contacts expect to end the winter with a substantial overhang of natural gas in storage.

Most manufacturers reported stable or declining prices, and nearly all contacts said inventories were in line with expectations. Retailers said price cuts were higher than planned and deeper than last year. While contacts in many industries noted the benefits of lower energy costs, most said selling prices were falling more than costs. Rising medical, property and liability insurance costs remain a serious concern.

Labor markets continue to loosen. Contacts in all industries report that it is easier to obtain quality workers and wage pressures have eased. There were fewer reports of future layoffs expected, but there were no reports of hiring and some contacts said they were not replacing workers when they leave.

Manufacturing. Manufacturing activity was flat to slightly down in late November and December. Demand continued to wane for construction-related products, such as fabricated metals, primary metals, cement and brick. Producers of fabricated metals are concerned because they are working off backlogs but have not seen an uptick in new orders. Contacts supplying commercial building are particularly worried about the outlook. The primary metals industry continued to contract.

Cement activity also declined, although this was partly due to weather delays. Contacts say most demand is coming from public works projects, and demand for private projects continues to falter. Brick sales fell slightly, and inventories are a little high. Lumber producers reported some seasonal slowing, but said that low mortgage rates were stimulating demand. Paper producers reported little change in activity with sales seasonally slower. Glass sales were also seasonally slower, and producers have cut production to keep inventories in line.

Demand for some high-tech products improved slightly since the last survey. Consumer demand for computers and related equipment remained good while demand from businesses was flat to slightly improved. Demand for telecommunications products was still down, however, with one firm reporting sales down 20 percent from this time last year. Most high tech contacts remain cautious, expecting little or no improvement in demand until the 2^{nd} quarter, at the earliest.

Energy-related manufacturers continued to report difficult conditions. Refiners have seen margins fall steadily throughout the last two months—to the lowest levels in two years—as gasoline and heating oil prices weakened steadily. Still, Texas and Louisiana refineries continued to operate at high levels. Demand for plastics and petrochemicals remained weak and a serious capacity glut in some products led to price declines for polyethylene, polystyrene, and polyvinyl chloride.

Services. Business service contacts say activity levels suggest the economy is faltering. Bankruptcy and litigation activity remains strong, while other activity is "dead in the water." Real estate activity is "okay" but has slowed. Demand for temporary services has been flat; demand is coming from the service sector, including retail, and some manufacturing. One service firm noted that their customers have projects and the money to execute them, but have decided to put them on hold until April.

The airline industry continues to struggle with weak demand and soaring security-related costs. The industry has significantly reduced capacity, with 15 percent fewer aircraft in service compared to a year ago. Industry capacity is roughly at 1997-98 levels. Price cuts stimulated strong leisure demand over the holidays, but business demand and international traffic remains weak. Revenues are 15-20 percent below last year's levels.

Retail Sales. Retail sales were weak in late-November and December but activity picked up right before and after Christmas, leaving most retailers near their expected level of sales. Sales were weakest at department stores and high-end retailers. "Tremendous" discounting helped clear inventory, and retailers say inventories are in line with last year. The last minute flurry of sales led to optimism about future sales growth because some "consumers are purchasing goods at a discount, where previously they weren't purchasing at all." However, many stores have reduced their purchases for the first quarter and do not expect sales to pick up much until the second quarter.

Auto dealers reported small declines in the number of cars sold. They believe this is due to the removal of zero percent financing. Contacts expect the first quarter of 2002 to stall because the financing incentives "bought up most of the market." Dealers expect an increase of rebates soon.

Financial Services. Loan demand remains flat overall. However, contacts at medium sized institutions are reporting strong growth for 2001 and good expectations for the coming year. Small business lending is stable, and refinancing activity has been strong. Perceptions that economic recovery later in the year will bring increased interest rates have pushed those on the fence to refinance or borrow money now. Consequently, lenders are optimistic about the coming six months. There were no reported changes to delinquency rates or other indications of a weakness in the bank performance measures.

Construction and Real Estate. Construction and real estate activity continued to weaken over the last six weeks. Office real estate activity has been slow, according to contacts who say they are cautious. Industrial activity is also slow, and some big box space has been vacant for over a year. Space that had been occupied by telecommunications firms is being refitted and re-marketed for other uses. Housing markets remain soft, particularly for higher priced homes. Contacts say cancellations are still widespread, and "it's getting harder and taking longer to get buyers to commit." Weakened job growth has hurt apartment-leasing demand, and concessions and incentives are on the rise. Investment in the multifamily market has weakened.

Energy. The U.S. rig count continues to decline rapidly, falling from over 1000 in early November to 887 at year-end. The decline seems to have been accelerated by warm weather, a build-up in natural gas and heating oil inventories, and uncertainty about OPEC's ability to sustain higher world oil prices. Capital spending in 2002 is expected to be down by about 20 percent. Some rigs have been leaving the Gulf to work international waters. The outlook for domestic service revenues remains unchanged, but the risk has grown that oil-related international work will weaken. The international rig count fell for the second consecutive month.

Agriculture. Harvest and land preparation continued in the plains but remained stalled in other parts of the district because soils were saturated. Supplemental feeding of livestock remained active, although growth of cool season grasses continued to increase and provide additional forage for livestock.

TWELFTH DISTRICT—SAN FRANCISCO

Reports from Twelfth District contacts indicated that economic activity continued to contract slightly in late November and December. Respondents reported steady or declining prices for most goods and services and little wage pressure. Holiday retail sales generally were lackluster, with some retailers faring better than others. Demand for travel and tourism stabilized in recent weeks, largely due to increased leisure travel. Manufacturing activity remained weak, although producers of some high-tech products noted a pickup in demand. District agricultural conditions showed little change during the recent survey period, as low prices and ample supplies continued to depress profits. Demand for residential real estate cooled slightly but remained at high levels. In contrast, conditions in commercial real estate markets deteriorated further, damping construction activity in many areas of the District. Falling loan demand, softening asset quality, and declining interest rate spreads characterized conditions among District financial institutions in recent weeks, but overall the industry remains healthy.

Prices and Wages

District respondents reported steady or declining prices for most consumer and business products and services in the closing weeks of 2001. Intense holiday discounting among retailers drove down prices for a wide range of manufactured goods, including apparel, electronics, jewelry, high-end appliances, and home furnishings. Price declines also were noted for energy, air travel, hotel and tour packages, and luxury nondurable goods such as wine and spirits, imported food products, and catered items. Business contacts reported falling prices for accounting and legal services, advertising and printing, and energy.

Rising unemployment continued to ease wage and salary pressures throughout the District. Contacts noted that starting salaries for low- and medium-skilled workers have returned to early 2000 levels, and that starting salaries for information technology jobs have fallen by 15 to 20 percent over the past year. Contacts in information technology, banking, and legal services reported the elimination of hiring bonuses, decreased moving allowances, and more limited merit increases. A number of contacts indicated that employees are being asked to pay a larger share of health care costs than in past years and to accept more limited health plan options.

Retail Trade and Services

Respondents throughout the District characterized holiday retail sales in late November and December as weak, but better than expected given the state of the economy. Sales were strongest at "big box" retailers, with several reporting modest increases in nominal sales over last year. Department store sales generally were flat to down relative to last year, as heavy pre-Christmas discounting offset any increases in sales volumes. Sales were weakest for apparel and high-end merchandise including jewelry and home furnishings. Electronics, such as computers, personal data assistants, DVD players, and video game machines reportedly posted the strongest sales, as consumers took advantage of low prices and delayed payment options. However, relative to last year, nominal sales gains for these items were modest. Prepared foods and wines reportedly sold well, with volumes and nominal sales surpassing year-ago levels. Numerous contacts noted that internet shopping increased in their region relative to last year, despite increased concern among consumers about mail service.

Travel and tourism providers reported modest improvement in airline, rental car, and hotel bookings in late November and December relative to September and October. Hotel industry contacts noted that occupancy rates stabilized in recent weeks, but remain well below year-ago levels. Although tourism around markets largely accessed by car such as Arizona, Southern California, and ski areas in Northern California and Utah continued to outperform markets dependent on air travel such as Hawaii, Las Vegas, and San Francisco, the gap closed somewhat compared to the previous survey period. The improvement in travel and tourism bookings was almost entirely in the leisure travel market where consumers have responded to lower prices. In contrast, contacts throughout the District reported ongoing restrictions on nonessential business travel, due largely to the weak economy. Despite the pickup in leisure travel, heavy discounting continued to depress profits in the industry.

Manufacturing

Although the District's manufacturing sector continued to contract in late November and December, contacts noted signs of stabilization, especially in the high-tech sector. High-tech producers reported fewer order cancellations and a slight pickup in bookings compared to the last survey period. In addition, inventories and capacity utilization remained steady or increased slightly. High-tech producers also noted that the pace of layoffs and job elimination eased in recent weeks.

Agriculture and Resource-Related Industries

Respondents reported little change in District agricultural conditions in recent weeks, with low prices and ample supply continuing to depress profits in the industry. Food safety has become a major concern of agricultural producers, with many investigating ways to protect against potential threats and working on ways to assure consumers of the quality of the products. On the bright side, contacts noted a pickup in export demand for a wide variety of agricultural products.

With the prices of most energy commodities falling, natural gas and oil producers have begun to reduce drilling activity. In addition, interest in siting and building electrical power plants has slowed, with some developers backing off their "fast track" approach and taking a more wait-and-see attitude.

Real Estate and Construction

District residential real estate markets remained solid through December, although signs of slowing were noted in most regions. Contacts reported relatively stable home prices but declines in rental rates, particularly for high-end properties. Demand for commercial properties continued to cool, particularly in Arizona, Northern California, and the Pacific Northwest. The slowing in commercial real estate markets tempered construction activity in most District states.

Financial Institutions

District financial institutions reported a slight weakening of conditions over the previous survey period. Respondents reported continued declines in net loan demand, especially among businesses, and some slowing in the demand for mortgage refinancing. Contacts also indicated that, while credit quality is generally good, signs of deteriorating asset quality have emerged. The most common theme among respondents was the negative effect that low interest rates have begun to have on interest rate margins and earnings. Respondents reported that bank capital and liquidity were ample, and that competition for quality borrowers remained intense.