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Current Economic Conditions

by Federal Reserve District

SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS BY FEDERAL RESERVE DISTRICTS

FEBRUARY 2002

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SUMMARY¹

A majority of Federal Reserve districts report some signs of improvement in economic conditions in January and early February. The Boston, Philadelphia, Richmond, Atlanta, Minneapolis, and San Francisco districts note some pickup in activity, Chicago cites a more positive tone, and Kansas City and St. Louis say that economic activity is weak, but there are some bright spots. Cleveland indicates that although some positive signs continue to emerge, overall business conditions in the district have neither improved nor deteriorated compared with the end of last year. New York reports mixed signals, and Dallas notes continued weak activity.

Most districts say that manufacturing activity is generally weak, but selected industries in some areas are showing more positive results. Boston, New York, Philadelphia, Atlanta, Dallas, Richmond, Kansas City, and San Francisco report modest improvements in retail sales recently compared with the end of last year. Retail results were more mixed in the other districts. Districts indicate that residential real estate markets are generally stronger than commercial markets. Reports on demand for bank loans are mixed across the districts. Warm, dry weather figures prominently in agricultural reports. Warm weather and the slow global economy have contributed to weaker energy demand.

Labor markets continue to be slack in most districts, with many citing business contacts who have suspended bonuses, frozen wages, or skipped annual salary increases. However, contacts at temporary employment firms in several districts suggest employment is bottoming out, and new hires in selected occupations are said to be in short supply. While wage and price pressures are described as "subdued" to "largely nonexistent," business contacts in many districts mentioned rising health insurance costs. Firms in most districts indicate that their purchase and

¹ Prepared at the Federal Reserve Bank of Boston and based on information collected before February 26, 2002. This document summarizes comments received from business and other contacts outside the Federal Reserve and is not a commentary on the views of the Federal Reserve officials.

selling prices are generally stable, but Dallas reports upward pressure on services prices and declining prices for chemicals and paper, while Cleveland notes an increase in spot market prices for steel.

Retail

Most districts report that retail sales during January and February were unchanged from a year earlier, but several noted improvement in early 2002 compared with late 2001. In addition, the Philadelphia, Atlanta, and Kansas City districts say that sales were higher in early 2002 than a year earlier. New York, Richmond, Atlanta, Kansas City, and San Francisco indicate that while tourism continues to be weak, it has improved since the second half of 2001. Home furnishings and appliances were reported to be growing strongly in the Cleveland, Richmond, Atlanta, St. Louis, and Kansas City districts. Philadelphia, St. Louis, Dallas, and San Francisco note that motor vehicle sales remain solid, but are down from the rapid pace set in the fourth quarter of 2001 because price promotions have ended; Dallas also reports that automobile dealer profit margins are lower.

Wage and price pressures in the retail sector are virtually nonexistent. Retail employment is said to be stable in Boston, but down in the Richmond and San Francisco districts. Most districts indicate that retail contacts expect flat to slightly increasing sales during the first half of 2002; only retailers in the St. Louis and Philadelphia districts expect somewhat stronger sales growth during this period. The Boston, Cleveland, and Kansas City districts say that retailers expect sales growth to resume at a modest pace during the second half of 2002.

Manufacturing

Manufacturing activity is reported to be generally weak but showing signs of improvement in at least some industries. The most positive reports come from Philadelphia and Richmond, indicating "moderate" or "solid" growth in manufacturing shipments and orders

and accounting firms note strengthening demand for work on litigation, bankruptcy, auditing, and taxes. Demand for communication services improved in the San Francisco district.

Conditions in the temporary labor market continue to be slack in most reporting districts, but the worst seems to be over. District reports suggest that widespread layoffs have subsided and demand for workers appears to be stabilizing. The Richmond district is the most upbeat, with reports of strengthening demand for temporary workers in recent weeks. Atlanta notes improvement in outplacement activity, even though labor market conditions remain weak. Other districts indicate that ample supplies of labor are still readily available, although certain areas of employment in some districts bucked the sluggish trend. The legal industry in New York exhibited strong demand for temps; employers in the Richmond district are seeking light industry workers and customer service representatives; and, in Dallas, demand was strong for administrative and clerical positions, and in the banking and retail industries and some professional services.

Banking and Finance

Loan demand is generally mixed in the reporting districts. Dallas, Kansas City, New York, and San Francisco report falling overall demand while Atlanta, Cleveland, Philadelphia, and Richmond report mixed results. Overall lending activity is picking up in St. Louis and Chicago. Demand for consumer loans is down or continues to be soft in the Cleveland, New York, and Philadelphia districts, but Atlanta is experiencing growth in demand. Commercial and industrial loan demand is similarly mixed, with Philadelphia and St. Louis reporting increasing demand, Cleveland and Kansas City showing lower demand, and the Chicago, Dallas, New York, and Richmond districts all indicating stable or mixed demand. Mortgage and refinancing loan volumes are steady to strong in the Atlanta, Chicago, Kansas City, and Richmond districts, with only New York and Philadelphia reporting slowing demand. New York, Philadelphia, and San Francisco all report stricter loan requirements, while the requirements in Chicago, Dallas, Kansas

City, and Richmond are reportedly unchanged. Delinquency rates are stable in Chicago,
Cleveland, Dallas, and New York. Cleveland and Philadelphia report some decline in loan
applicant quality. Richmond reports that stock market investors are "in a holding pattern," and
Atlanta's contacts note that there is little new money entering the venture capital industry.

Real Estate and Construction

Real estate markets are mixed, with commercial markets almost universally said to be weak while the residential segment remains strong. Increased office vacancy rates are reported in the Boston, New York, Philadelphia, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Dallas, and San Francisco districts. The rise in available commercial space has been exacerbated by active sublease markets and additional construction in some areas. Office rents have declined moderately compared with a year earlier. Consequently, commercial construction activity has slowed in most reporting districts.

Residential markets remained steady or strengthened during the last two months. Home sales and demand for houses are reported to be strong in the New York, Philadelphia, Richmond, Atlanta, Chicago, St. Louis, Kansas City, and San Francisco districts. Lower-priced home sales are especially strong, while demand for the high-end segment of the market has weakened in a few districts. New York, Philadelphia, Chicago, and Minneapolis note increased home sale prices compared with a year earlier. New home construction was unchanged or increased in Cleveland, St. Louis, and Minneapolis, but was lower than a year ago in Kansas City.

Agriculture and Other Natural Resources

The unusually warm, dry weather in much of the country dominates news from the agricultural sector. The dry spell has resulted in poor conditions for the winter wheat crop or has reduced winter pasturage in the Richmond, Minneapolis, Kansas City, and Dallas districts. As a result, Dallas district ranchers are reducing their herds. But in San Francisco, where farmers have already cut their inventories of cattle and field crops, they now report improved prices. Despite

producer concerns about the farm economy, Kansas City district bankers indicate that farmers' balance sheets remain strong, thanks to steady land values and government support. St. Louis contacts also report a slight rise in land values. Looking ahead, Dallas notes that preparation for the corn and cotton crop is on schedule, and that, despite a cotton surplus and low prices, farmers are planning to plant as normal. In the St. Louis district, farmers expect to plant less wheat and cotton than last year; however, they are waiting for passage of the federal farm bill before finalizing their plans.

According to the Atlanta and Dallas districts, the second warmest U.S. weather on record for November through January plus global economic weakness have damped demand for heating oil and natural gas and have kept prices low. Minneapolis reports that drilling activity has fallen slightly in recent weeks, while Kansas City notes that the district's count of active oil and gas drilling rigs remains near the two-year low hit in late 2001. In the Dallas district, energy activity shows signs of bottoming out and stocks of crude oil, heating oil, and natural gas are all well above last year's levels. Because firms storing natural gas will not want to hold it over the summer, many Dallas contacts expect significant downward pressure on natural gas prices this spring. In the case of mining, Minneapolis iron ore production is up slightly from late 2001 levels and is nearing more normal levels. In Kansas City, higher coal prices have encouraged increased activity.

FIRST DISTRICT - BOSTON

Business conditions are improving in the First District. Manufacturers and retailers report more positive results in mid-February than they did at the beginning of the year, and software contacts say business is picking up. The commercial real estate market is said to be on the bottom, no longer moving down, and staffing firms are seeing some improvement, but business is still very slow. Most contacts expect activity levels to improve very modestly later this year.

Retail

Retailers report generally improving sales results in early 2002. Sellers of furniture, lumber and home improvement products, shoes, and surplus merchandise indicate that sales through mid-February were above year-earlier levels, though mostly by small amounts. Even a computer retailer with sales down 20 percent from a year earlier says business in recent weeks has been "less bad than it was."

Employment is reported to be stable at most retail firms; head counts are generally level with year-earlier. One company with "major, major" layoffs in the last year is not currently planning further cuts. Wage trends are mixed, with one firm planning "the usual" 3 percent pay hike this summer, another seeing costs jump because of a rise in the minimum wage, and a third instituting a wage freeze.

Retailers say vendor prices are fairly stable. In most cases, their selling prices are also steady, although one firm is raising prices on selected products. The computer retailer reports that the pace of price declines increased in the last half of last year but has attenuated in the last three months.

Contacted retailers are expecting the economy and their businesses to improve in 2002. One respondent says he foresees "something between dead flat and the beginning of a very modest recovery."

Most see the improvement concentrated in the second half and none expects a strong upturn.

Manufacturing and Related Services

Most First District manufacturing contacts report that revenues in the fourth quarter of 2001 and early 2002 were fairly flat relative to a year ago. By exception, demand for biopharmaceutical equipment and supplies remains on a solid growth path. Manufacturers indicate that discretionary spending by

business customers remains depressed. This weakness affects sales of a variety of products, from corporate gift and promotional items to major office equipment. To the extent that their business has improved of late, manufacturers describe the changes as limited. For example, a firm in the semiconductor industry attributes the pickup in orders since mid-January to a replenishment of stocks by distributors – not (yet) to a rise in final demand. A manufacturer of paper products reports that some of its customers seem to be enjoying resumed sales growth, but others are simply restocking.

Contacts report that selling prices and materials costs are generally flat. In a variety of industries, respondents indicate that they are not even considering higher price quotes because they would not stick.

Contacts continue to express concern about steep increases in insurance rates.

Manufacturers remain intent on controlling costs. They are avoiding higher input costs by pressuring their vendors or shifting to lower-cost sources. Most contacts reduced employment in 2001, and most anticipate that their headcounts will be steady or drifting downward in the remainder of 2002. Pay raises will be nonexistent at some firms and limited to 2 to 3 percent at others. Most contacts reduced inventories last year and are contemplating no buildup from current levels. In describing capital spending plans, manufacturers expressed a "do with what we have" mentality, especially with respect to technology investments. Many say they will focus on maintaining their existing capital and investing to develop new products.

Revenue expectations for 2002 generally are muted. Although the consensus continues to be that business will improve, manufacturers remain doubtful that they will see any substantial pickup until sometime in the second half of the year.

Temporary Employment

Respondents in the staffing industry report mixed results in the first quarter of 2002 (to date), but most are performing better now than in the fourth quarter of 2001. Some contacts say that the current market is the worst they have seen; others are more upbeat because orders are starting to come in.

Almost all report lower revenues than a year ago. Even with some signs of a pickup for temporary work, permanent placement is still lackluster. Responding firms in northern New England are doing better than

those located in Massachusetts and Connecticut. On the supply side, temp firms continue to be inundated with job seekers. Most contacts predict a modest turnaround later this year.

Commercial Real Estate

Commercial real estate markets in New England have maintained their slow pace over the past quarter. Vacancy rates remain high and rents have declined somewhat, although contacts report that "the worst is behind us," and the pace of deterioration has slowed markedly. The Greater Boston market is still in "bad shape," but vacancy rates have stopped increasing and contacts predict that "we have reached the bottom." The level of activity is much slower than a year ago, but has not changed much over the past quarter. Other parts of New England have been stable, with no noticeable changes in vacancy or rental rates. Contacts in Connecticut, Rhode Island, and Maine report increased activity levels relative to the last quarter of 2001. Most contacts do not anticipate any significant improvement before the end of 2002. Software and Information Technology Services

A majority of technology respondents are beginning to see signs of improving demand for software products and services. Respondents who provide infrastructure software report particularly strong fourth quarters, while those who provide products more closely related to consumer services are not faring as well. Large customers are said to have activated plans and finalized agreements that they had put on hold for almost a year, while small companies are still holding back on some technology investments. Contacts servicing the healthcare and insurance industries have particularly strong sales. The improving technology environment has made most of the respondents more optimistic than in the recent past, but they are still very cautious regarding the future. One of the best performing respondents still believes that the technology industry is "scary as hell." Most contacts plan to keep employment level until their prospects are more certain; only one company expects to increase its workforce significantly. A couple of respondents report plans to upgrade their job mix while keeping their headcounts constant by increasing the number of research and development workers while reducing customer service positions and installers. Capital and technology spending also appears to be level for most respondents.

SECOND DISTRICT--NEW YORK

Economic conditions in the Second District have been mixed since the last report, with hiring remaining weak but housing quite strong. Retail sales, which had been a bit lean in January, were generally reported to be back above plan in February. Retailers indicate that selling prices have been steady in early 2002. Purchasing managers report mixed business conditions in January, though a survey of manufacturers across New York State suggests ongoing improvement in general business conditions in early February.

Housing markets appear to have gained further momentum since the last report, in both metropolitan New York City and parts of upstate New York. New York City's office market has shown signs of bottoming out, though suburban markets have slackened further. Manhattan hotels experienced less of a seasonal slowdown than normal in January. Finally, bankers report some weakening in demand for consumer loans and home mortgages, ongoing tightening in credit standards, and a slight up-tick in consumer delinquency rates.

Consumer Spending

Major retail chains report that January sales were constrained by lean post-holiday inventories, but most indicate that business was back on or above plan in February. Comparable-store sales in recent weeks have been little changed from a year earlier, with brisk sales of home goods offsetting sluggish apparel sales—particularly men's apparel. In general, discounters continue to fare better than department stores. Similarly, small retailers across New York State indicate that business has been little changed from a year ago, but, in most cases, this was better than had been expected. Selling prices are reported to be flat, though the lack of clearance merchandise in January translated into less discounting.

According to Siena College's latest monthly survey of New York State residents, confidence was little changed around the District in January. More recently though, the Conference Board reports

that consumer confidence in the Middle Atlantic region tapered off in February.

Construction and Real Estate

Commercial real estate markets remained generally weak in early 2002, though conditions in Manhattan appear to have stabilized. While availability rates in Lower Manhattan continued to climb in January, rates in Midtown retreated noticeably. Asking rents in both areas were down substantially from a year earlier, and the drop in contract rents is said to have been even more pronounced. Office markets in New York City's suburbs, though, slackened considerably in recent months—particularly in southwestern Connecticut and northern New Jersey. Markets in New Jersey are being dampened by a substantial amount of sublease space, mainly from telecommunications firms, and by a large volume of space recently completed and under construction. Across the metro area in general, asking rents were slightly higher at the beginning of this year than in early 2001, but landlords are reported to be offering more concessions. Despite the sluggish leasing market, sales transactions are described as fairly strong across the metropolitan area.

In contrast, the residential market has continued to gain momentum. A leading New York City housing appraisal firm and a major brokerage both report a substantial pickup in the co-op and condo market in January and early February. Apartment sales activity has been brisk in recent weeks, with selling prices up modestly from a year earlier and transactions volume up substantially. In addition, the inventory of available homes is back down, and bidding wars are, once again, increasingly common.

The single-family housing market has also been quite strong. Homebuilders in northern New Jersey report a brisk rebound in demand and indicate that a supply shortage is again buoying home prices. Similarly, existing home sales prices in late 2001 were up on the order of 10 percent across most of the District, while sales volume was up slightly.

Other Business Activity

A major New York City employment agency reports a slight improvement in hiring activity in January and February, compared to the fourth quarter of last year, but no significant momentum. This contact indicates a deluge of resumes from technical people but very few such openings. The strongest labor demand is still reported to be coming from the legal industry, but there has been some pickup from a smattering of small firms in creative fields, such as public relations, advertising, and film.

Manhattan hotels report that occupancy rates posted a normal seasonal decline in January. After adjusting for seasonal movements, January's occupancy rate was 78 percent, virtually the same as in December, and down only 4 points from a year earlier. The average room rate was down about 15 percent from a year earlier in January, compared with declines of 20-25 percent in the fourth quarter of 2001. Industry contacts note that business remained relatively favorable in February, buoyed by the World Economic Forum meetings.

There are indications of improvement in New York State's manufacturing sector. A rising proportion of manufacturers across New York State report improvement in general business conditions and a sizable majority express optimism about the near-term outlook, based on a survey conducted in early February. However, surveys of purchasing managers offer more mixed results. New York City area purchasing managers report some weakening in business conditions in January—particularly in non-manufacturing sectors. Buffalo-area purchasers indicate that both production and new orders continued to decline in January, though declines were less widespread than in December. However, Rochester-area purchasers report modest improvement in business conditions in January, following a sharp pickup in December. Purchasers in the New York City area report fairly widespread declines in input prices, while those in the Buffalo area indicate moderate increases.

Financial Developments

According to the latest survey of small to medium-sized Second District banks, overall loan demand receded somewhat since the last report, driven largely by the consumer side. Nearly half of those surveyed report slower demand for both consumer and residential mortgage loans, but demand remained stable for commercial and industrial loans. Fairly widespread declines were reported in refinancing activity. Bankers reported continued tightening in credit standards for all types of loans. In particular, while none reported an easing of standards, roughly one in four bankers reported tighter standards on both nonresidential mortgages and commercial and industrial loans. Loan rates were steady to lower, while deposit rates decreased. Delinquency rates were reported unchanged for all types of lending except for consumer lending, where there was a moderate increase.

THIRD DISTRICT - PHILADELPHIA

Business conditions in the Third District showed some signs of improvement in February. Manufacturers reported increases in shipments and orders. Retail sales of general merchandise have been rising modestly, and auto sales have been steady. Sales of new and existing homes have been running at a fairly high rate. However, there were clear indications that commercial real estate markets have weakened. Bank loan volumes have been flat, and slight growth in business lending has been offset by a decline in consumer loan balances.

The consensus among Third District businesses surveyed in February is that there will be slow growth in the region during the rest of the year. Manufacturers expect gains in shipments and orders. Retailers anticipate modest improvement in sales. Auto dealers expect the current sales rate to carry through most of the year. Bank credit officers generally forecast slow growth in overall lending, with gains in commercial and industrial loans as well as consumer credit but a falloff in real estate lending. Contacts in the commercial real estate industry forecast steady market conditions for the first half of the year and some increase in demand for space in the second half of the year. Residential real estate contacts expect sales of both new and existing homes to be steady through most of the year at around the current rate.

MANUFACTURING

Third District manufacturers reported moderate gains in activity in February, continuing the improvement that began in January. Orders and shipments increased in February at about the same pace as they had in January. Business conditions improved somewhat more for makers of durable goods, such as metal products and industrial equipment, than for makers of nondurable goods, such as apparel and food products. Area manufacturers kept working hours steady in February but reduced employment. On balance, industrial firms continued to reduce inventories, although half of those contacted for this report said they were maintaining steady inventories. Three out of four manufacturers in the region indicated that prices for both inputs and for the goods they

manufacture were steady in February. The number of firms reporting falling prices has been declining for the last few months.

Local manufacturers have positive forecasts. Over half of the firms surveyed in February forecast increases in orders and shipments during the next six months, while around one in 10 anticipate decreases. On balance, area firms have raised capital spending plans, but increases are modest and spotty across the major industrial sectors in the region. Several chemical and plastics companies have scheduled increases in outlays for the first half of the year. Capital spending in other manufacturing sectors is likely to be flat or up just slightly.

RETAIL

Third District retailers reported modestly rising sales during February. Sales growth was noted across nearly all lines of goods, with the relatively strongest growth for jewelry and electronics. However, warmer than normal weather has held down sales of winter coats and some other seasonal merchandise.

Most area retailers said their inventories were at appropriate levels. Stores in the region have increased discounting to spur sales of winter merchandise during a prolonged spell of warm weather, but they have been conservative in their buying of spring merchandise and do not expect to make significant markdowns on spring goods. Store executives believe consumer confidence may be firming, and some have raised their sales forecasts for the year. On average, they expect sales for the year to be around 5 percent above last year, on a comparable stores basis.

Auto sales in the region were steady in February. Although below last year's high rate, the current pace of sales was described as good by most of the dealers contacted for this report, as manufacturers' incentives continued to attract car buyers. Inventories were generally described as in line with sales. Dealers expect sales to continue around the current rate through most of the year.

FINANCE

Outstanding loan volume at Third District banks has been virtually flat in recent weeks. Some banks have seen modest growth in business loans, but consumer credit has

declined somewhat. Mortgage refinancing activity has started to ease at most banks in the region, and bank lending officers expect a substantial decline in the next few months. Most of the bankers contacted for this report indicated they were limiting their commercial real estate lending activity even though local developers were continuing to seek financing for new commercial and industrial projects. Bank lending to residential developers appeared to be steady, for both single-family home building and multifamily housing construction. In general, although bankers noted some deterioration in loan quality, both commercial and consumer, they indicated that the decline has been within the parameters they had anticipated.

Bankers in the Third District expect overall loan demand to increase slowly through the year. They expect a modest economic recovery with commensurate growth in business and consumer lending, but they anticipate that residential real estate lending, both refinancing and purchase mortgage activity, will be slower this year compared with last year.

REAL ESTATE AND CONSTRUCTION

Third District commercial real estate markets have eased since last fall.

According to surveys by commercial real estate firms in the region, the office vacancy rate in the Philadelphia central business district has increased by about 2 percentage points, to around 12 percent. Vacancy rates have increased more in suburban office markets, to an average of around 15 percent. Vacancy rates are higher in the suburbs because more new space has become available in suburban areas and more space has been made available for sublease by firms that have scaled back operations or gone out of business. Many of these firms were high-tech or e-commerce companies. Rental rates have decreased, and in some markets, landlords have begun offering tenant improvement allowances. There has been some renegotiation of soon-to-expire leases to extend them for longer terms at reduced rates. Demand for industrial space has been fairly steady in most parts of the Third District, although vacancies have increased in a few areas where new buildings have become available. Commercial real estate agents expect demand for office space to be steady through the first half of the year and pick up during the second half. They expect demand for industrial space to be steady through most of the year.

Residential real estate agents generally reported steady sales of both new and existing homes. Sales have been running at a fairly high rate in most price categories except for the very high end, where sales have slipped. Price appreciation has been steady, except for very expensive homes. Price appreciation for these homes has slowed in recent months. Home builders also reported steady sales, although below last year's rate. Builders' backlogs remain high. Real estate agents and builders indicated that relatively low mortgage interest rates continue to support home sales, and some real estate agents believe there has also been a shift in consumer attitudes favoring home purchases over financial investments. Real estate agents and home builders anticipate relatively steady sales at around the current pace during the rest of the year.

FOURTH DISTRICT - CLEVELAND

According to reports gathered the third week of February, business conditions during the first six weeks of 2002 remained much the same as in the last six weeks of 2001. Very few signs of further deterioration in conditions were evident in reports from our contacts, and signs of modest improvement continued to emerge throughout the District. The manufacturing sector continued to report slight improvement, retail noted strong sales of home-related items, construction activity remained strong, and, for the first time in more than a year, some improvement was reported in the trucking and shipping industry.

Labor markets, however, continue to struggle. Demand for temporary workers softened again in January, with some contacts reporting that demand for temporary workers was down at least 50 percent from a year earlier. Modest improvement was seen in requests for the first two weeks of February, and most contacts believe conditions will improve during the second quarter, because they are beginning to receive inquiries and initial business proposals requesting temporary help for later in the spring.

Job security is still the number-one concern among organized labor. Hiring freezes remain in effect across most industries, but contacts noted that widespread layoffs in industries such as steel and aerospace during the last three months of 2001 appear to have subsided. Some bargaining units in the public sector reported substantial wage increases (from 5 percent to 8 percent annually). Health care continued to be a point of contention in labor negotiations because employers attempted to pass through some of the increasing costs of health care to their workers. In some cases, disputes over health care benefits have led to strikes.

Manufacturing

Modest improvements were seen in manufacturing over the last six weeks, as slightly more manufacturers reported an increase in new orders, and there were slight increases in production throughout the District. Most manufacturers reported lower employment levels than in previous months, but indicated that they did not anticipate more layoffs.

None of the District's automakers reported plant closings during the first six weeks of the year, and a few plants reported three consecutive weeks of scheduled overtime to meet booming demand for their models, the first time this has occurred in the District in more than six months. In the steel industry, conditions remained mixed. Several companies reported that they had

implemented 3 percent to 5 percent price increases for hot-rolled steel. On the other hand, contacts noted that the length of time it takes to collect accounts receivable has been increasing. Plans for capital improvements remain on hold until steelmakers see substantial improvement in industry conditions. Most contacts believe that this will not occur until fourth quarter 2002: although improvement already has been seen in spot market prices, changes will not be complete until contract prices (which comprise over 60 percent of industry sales) are renegotiated at the end of this year.

Retail Sales

As in the last six weeks of 2001, the first six weeks of 2002 showed mixed conditions in the retail sector. Discount retailers continued to report significant improvement in conditions (one contact reported year-over-year sales were up almost 17 percent). Apparel retailers, however, reported continuing declines in year-over-year sales figures, with reports of declines as high as 14 percent for the first six weeks of the year. In general, items related to the home, such as furniture and decorations, electronics, and appliances, have shown strong sales over the last six weeks.

Nearly all retailers noted that their conservative sales plans have led to solid inventory positions. One contact noted that inventories are currently running 25 percent below the same period last year. Most retailers continue to run promotions at a normal pace and have not resorted to heavy discounting.

Most retailers' plans for capital expansion remain in effect, but some have scaled back the number of store openings planned for this year. In general, contacts continue to expect retail sales for the first half of 2002 to be flat or slightly better than the first half 2001 and to improve in the second half of the year.

While some auto retailers reported slight increases in January sales compared with December, most reported that sales were flat compared with January 2001. Although dealers do not expect year-over-year increases for 2002 (sales for 2001 were the second-highest on record), they are optimistic that pace of sales will improve substantially in late March or early April, and that the higher level of sales will persist throughout the year.

Construction

Both commercial and residential builders throughout the District continued to characterize business conditions as "favorable." Most homebuilders reported that customer traffic continues to be strong, with year-to-date sales for 2002 comparable to those the first six weeks of 2001.

Commercial builders are optimistic about business in the months ahead. Like residential homebuilders, they have seen the number of customer inquiries remain unusually strong since the year started. Many expect demand to accelerate in the latter part of 2002; several contacts noted that architects appear to be very busy, a sign that companies are going ahead with plans for expansions.

Trucking and Shipping

Nearly equal shares of contacts reported a decline, constant activity, and an improvement in industry conditions over the first six weeks of 2002. This report is the first time in more than a year that a significant number of contacts noted improvement in the industry. Overall, shipping activity for the first six weeks was slightly off from the same period last year, but the year-over-year decrease has narrowed compared with the year-over-year decline seen during the last six weeks of 2001, suggesting some improvement in conditions. Many carriers also reported that the first two weeks of February showed an increase from January. While most contacts noted that no single product area has been doing relatively well or poorly, some noted that shipping of manufacturing-related goods did not decline and may have been up slightly compared with the last six weeks of 2001.

Some companies have been able to phase in minor rate increases, but competition has kept companies from raising rates significantly, with some contacts even reporting rate decreases. Diesel prices and associated surcharges remain low and are still less of a concern to carriers than insurance costs, which have increased substantially.

Rather than replacing existing trucks and trailers, companies are spending to maintain existing equipment as much as possible to manage costs. Capital expenditures are not likely to show an increase over the low levels reported for 2001.

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 a decrease in demand for commercial loans, while trends in consumer loan demand were mixed among contacts. Roughly half of contacts reported that the credit quality of loan applicants had diminished; the other half reported an unchanged credit quality. Although one contact reported an improvement in the loan delinquency rate, all others reported no change. Most banks reported either no change or a tightening of the net interest margin.

FIFTH DISTRICT-RICHMOND

Overview: Fifth District economic activity advanced at a moderate pace in January and February, led by somewhat stronger growth in the retail and manufacturing sectors. Services firms reported modest increases in revenues, and sales growth at retail establishments rebounded in February after sagging in January. Manufacturers reported that shipments grew more rapidly and new orders increased substantially. In contrast, activity at residential and commercial real estate firms was little changed. Bankers reported steady demand for residential mortgages but somewhat sluggish growth in commercial lending. Employment fell in the manufacturing and retail sectors, but temporary employment agencies reported that the demand for workers picked up. In agriculture, warm and dry weather aided field preparation but stressed pastures and triggered supplemental feeding of livestock.

Retail: District retailers said that seasonally-adjusted revenues fell in January but rebounded in the first three weeks of February. Big-ticket sales were generally higher, although automobile dealers gave mixed reports on customer traffic and vehicle sales in February. A number of retailers told us that they had trimmed inventories; a big-box retailer and a manager at a home improvement center said they were carrying lower inventories because of the sluggish economy. Retail employment edged downward in recent weeks while average wages increased at a moderate pace. Prices in the retail sector were reported to be rising at less than a two percent rate.

Services: Services businesses reported modestly higher revenues in the weeks since our last report. A manager at a fitness center in Charlotte, N.C., said customer demand had picked up in recent weeks, while a travel agent in Greenville, S.C., reported an increase in both business and pleasure travel. Also in Charlotte, an engineering firm reported a jump in orders for both government and private sector projects. But a financial services firm in Baltimore, Md., said stock market investors were concerned that there may be more bad news regarding corporate accounting methods and remained "in a holding pattern." Employment in this sector declined in January but rose modestly in February.

Manufacturing: District manufacturing activity strengthened in January and February, led by solid growth in shipments and new orders. Contacts in the electronics, furniture, paper, tobacco, and transportation industries generally reported moderate growth in shipments in recent weeks. A paper company in Richmond, Va., introduced a new product and accordingly, February appeared to be "a very good month" for orders and shipments. In addition, a producer of plastic products in North Carolina noted that January was "a good, active month" and that shipments were higher.

While uncertain whether this was "truly the beginning of the recovery," he nevertheless anticipated that shipments in coming months would be higher. The level of manufacturing employment declined since our last report, but manufacturing wages and the average workweek rose. Looking forward, most manufacturers remained very optimistic about business prospects six months from now, expecting higher shipments, new orders, and capacity utilization.

Finance: District loan officers reported that lending activity was little changed since our last report. Growth in commercial lending activity continued to be constrained by sluggish demand for business loans. Several commercial lenders noted that some of their borrowers continued to have weak profits and were not looking to expand their business operations at this time. While commercial lenders reported little change in credit standards, several said they were taking a closer look at financial statements before extending loans, particularly for companies restating earnings. Residential mortgage lenders said that refinancing activity had declined in recent weeks, but that overall demand for mortgages was holding steady. A Greenville, S.C., banker described demand for residential mortgages as "steady, but not great," despite a dip in mortgage interest rates in recent weeks.

Real Estate: Residential real estate activity was mixed since our last report. Several realtors reported that home sales were exceptionally strong in their areas. A contact in Chevy Chase, Md., said that sales in his area were "hot"—he had an "enormous number of buyers" but not enough inventory. A realtor in Richmond, Va., reported that houses were selling quickly there and that the "spring market" had begun earlier than usual this year. In addition, a homebuilder in the Tidewater, Va., area said the market was the most robust he had seen in his 25 years in the business. But other contacts described slowing home sales. A realtor in Baltimore, Md., noted a "slight softening" in the market there, while a realtor in Columbia, S.C., characterized home sales as "quiet." While most realtors continued to report that sales were strongest in the lower price ranges, a builder of homes in the Carolinas said that the upper-end market was "making a comeback."

Commercial realtors across the District reported little change in leasing and construction activity since our last report. Leasing activity rose slightly in the industrial sector, but was flat in the office and retail sectors. Vacancy rates continued to edge up across all sectors and a number of District contacts noted the persistence of a "wait and see" attitude among clients. Rents stabilized in the retail and industrial sectors, but declined further in the office sector. The rate of new sublease space coming onto the market declined across the office and retail markets. A Northern Virginia realtor reported that the office-sublet market was finally starting to "firm up" and that vacant space

was being absorbed by "a variety of users." Although a smattering of new projects were reported, new construction activity remained generally flat across the District.

Tourism: District tourist activity continued to be mixed in recent weeks. A manager at a ski resort in West Virginia told us that the pace of business had picked up considerably in February and that record attendance was expected in March. A counterpart at a resort in Virginia, however, reported that business was off 30 percent from a year ago—unseasonably warm and dry weather had caused a shortage of water reserves essential for making snow. But mild weather boosted tourist activity at coastal resorts. A contact on the Outer Banks of North Carolina said that bookings during Valentine's Day and the Presidents' Day holiday weekend were much better than a year ago, which she attributed in part to patrons taking holidays closer to home because of ongoing concerns with air safety. Looking ahead, tourism industry contacts were encouraged by the strong pace of spring bookings, with some areas being booked to capacity through June.

Temporary Employment: Temporary employment agencies in the District reported continued strengthening in the demand for workers in recent weeks. Employment agents in Northern Virginia, Richmond, Va., and Rockville, Md., told us that demand for workers had risen in recent weeks and that they expected demand to continue to rise over the next six months as the economy rebounds. A contact in Hagerstown, Md., said that demand was "somewhat weak" at her firm, but noted that she was beginning to see "hopeful signs of increased customer activity." Light industrial workers and customer service representatives were among the most highly sought employees in the District.

Agriculture: Mild weather in January and much of February allowed District farmers to make good progress in field preparation. Dry conditions, however, persisted in many areas of the District. Some areas of North Carolina and Virginia will require several months of above-normal rainfall to fully replenish soil moisture. In North Carolina and West Virginia, sparse rainfall prompted earlier feeding of livestock and hauling of water in some areas, while in South Carolina supplemental feeding of livestock continued because of poor pasture conditions. Small grains in most areas of the District were reported to be progressing well despite the arid soil conditions. Agricultural analysts noted, however, that additional precipitation was needed to keep small grain crops in good condition.

SIXTH DISTRICT – ATLANTA

Summary: Sixth District contacts reported improved conditions in many sectors during January and early February, and most noted cautious optimism regarding the near-term outlook. The majority of retail contacts described sales as exceeding their expectations. Automobile sales did fall from the robust pace of past months, but inventory levels were mostly described as acceptable. Reports indicated positive signs from the manufacturing sector as orders and inventories were stabilizing. The defense industry, in particular, received a significant boost in new orders. Residential real estate markets maintained their strength, but contacts noted that weakness persisted in the District's office and industrial markets. The improving trend in the tourism and hospitality industry also continued, although hotel occupancies remained below those of a year ago. Bank lending activity was still sluggish, and remained supported primarily by robust mortgage refinancing. Price pressures were subdued overall. Several contacts noted rising health care, insurance, and security costs.

Consumer Spending: Reports from District retailers were upbeat in January. Most indicated that sales were above year-ago levels. There was some softening noted in early February, but most contacts indicated that recent sales had met or exceeded expectations. Apparel and home-related products were reported to have sold well. The majority of contacts anticipated that sales would rise moderately in the first half of the year compared with the same period last year. In contrast, District automobile sales were weak during January and the first part of February, as remaining incentive programs failed to significantly boost sales. Despite the softer conditions, no major imbalances were reported in automobile inventory levels.

Real Estate and Construction: Low mortgage rates continued to support strength in the District's single-family housing market, with contacts noting that the Florida market remained

particularly robust. Most reports indicated that District home sales during January and early February were near the previous year's level. Home construction was described as near or slightly ahead of last year. Home inventories and new home construction was seen as balanced, although several contacts noted that Florida's housing inventory was low. Looking to the spring selling season, most contacts were cautiously optimistic.

District commercial real estate markets remained weak in January and early February.

Office and industrial vacancy rates continued to run at high levels and prices were under downward pressure. The majority of new construction work is government-related or small build-to-suit projects.

Manufacturing: Reports on the District's manufacturing sector during January and early February were mixed, but generally suggested improved conditions. Alabama steel processors noted that conditions did not worsen in January and several District paper mills and lumber manufacturers reported maintaining employment levels. Orders for building products were described as picking up in some areas. The region's aerospace industry received a boost with new orders from defense contractors, and hiring for Nissan's new plant in Mississippi continues. On a less positive note, contacts reported a further contraction in the textile and apparel industry with a large plant closing in Mississippi and problems for some producers in Tennessee related to the Kmart situation.

Tourism and Business Travel: The hospitality and tourism industry in the District continued to recover through mid-February. Convention and conference bookings in Florida and Georgia were improving, although contacts noted that attendance at many events was subdued. Cruise lines out of Miami were sailing at near capacity levels and the use of deep discount pricing was less prevalent. South Florida hotel occupancy rates continued to be adversely

affected by a dearth of international tourists. However, attendance at central Florida theme parks continued to improve, and report's on the President's Day weekend were upbeat.

Financial: Overall bank lending remained sluggish in January, but contacts noted that mortgage refinancing continued to be strong. Consumer loan volume at credit unions was also strong in some areas. The pace of investment bank activity was reported to have improved slightly, although direct commercial lending remained subdued. Contacts also noted that there was little new money entering the venture capital industry.

<u>Wages and Prices:</u> Labor market conditions remained weak in January and early February. Many businesses reported that they were willing to incur overtime costs in the short term rather than hire additional workers. Nonetheless, outplacement firms reported some improvement in activity, although it was noted that it was taking much longer for people to find employment than a year ago.

Prices were described as stable by most accounts. However, continuing increases in health care costs, security costs, and insurance was noted, and price discounting for rental cars and cruises were ending. Reports from the Gulf coast noted that high natural gas inventories and continued warm weather were keeping natural gas prices in check.

Agriculture: Citrus growers in Florida benefited from recent rains and colder temperatures, but the outbreak of citrus canker disease in prime Indian River tree areas could have a significant impact on Florida's citrus crop and on citrus prices.

SEVENTH DISTRICT—CHICAGO

Summary. Reports of Seventh District economic activity through mid-to-late February were mixed, but the overall tone was more positive than earlier in the year. Consumer spending remained mostly soft in the region, though there were some signs of strength in a few sectors. Real estate and construction activities were again mixed, with continuing vigor on the residential side and softness on the business side. Manufacturing activity was generally weak, but there were more frequent reports of increasing production and new orders. Lending activity appeared to increase modestly, with firming loan demand from businesses. Labor markets slackened modestly, with most contacts saying that the worst of the region's job losses had passed. There were no new indications of intensifying pressure on wages or prices at the retail level.

Consumer spending. Reports on consumer spending through mid-February were mixed, but generally indicated relatively weak spending. Several contacts reported that sales results in the Midwest were softer than in other regions. One discount retailer noted that sales of staples and discounted items remained strong, but sales of discretionary merchandise were softer. Entertainment spending was mixed. With favorable weather said to be helping consumers get out and about, theater revenues were reported to be up between 5 percent and 10 percent so far in 2002. But sales results at casual dining restaurants remained generally soft, with one industry contact saying that conditions were "hard to read." Regional auto sales also were said to be mixed, but generally weaker than late last year. Reports on tourism and travel varied. A contact with one airline reported strong load factors, and said the company was planning to add 7 percent or 8 percent to its flight capacity, mainly through increased domestic flights. At the same time, United Airlines announced publicly that on April 1 it would be calling back 1,200 of its recently furloughed flight attendants, over one-third of whom are based in Chicago. Other contacts, however, suggested that tourism and travel in the region was softer than they had expected. Signs of intensifying pressure on retail prices were virtually nonexistent, as most contacts said that customers remained very value conscious.

Construction/real estate. Reports from real estate and construction contacts were also mixed; residential activities generally remained brisk, while nonresidential activities were slower.

Low mortgage interest rates continued to buoy existing home sales in the region. A contact with one of the largest independent real estate companies in the District said that January home sales were a record for the month and remained strong in February. Home price appreciation was said to be slowing somewhat from the very strong rates realized over the last few years. New home sales and starts were down modestly from a year earlier, but builders remained busy according to most contacts. Both realtors and builders indicated that first-time buyer and trade-up homes sold well, while high-end sales remained weak. Apart from some over-building in the downtown Chicago condo market, contacts reported that inventories of new residential units were normal to slightly low for this time of year. Nonresidential building and leasing activities were again soft. Office vacancies continued to increase in most metro areas, though there were some isolated reports of decreases. Landlords were more proactive in securing leases by offering more generous incentives and lowering rental rates. Light industrial vacancy rates were also increasing in most areas, albeit at very modest rates. Development of new retail space remained fairly strong in some areas, but contacts noted that the number of projects in pipelines was falling, as a generally softer economy led some retailers to postpone or cancel expansion plans.

Manufacturing. Manufacturing activity remained generally weak, but reports of increased production and new orders became more frequent. Many contacts said that with inventories very lean, the worst for the manufacturing sector was over. Light vehicle sales nationwide were robust again in January and through mid-February, exceeding most analysts' expectations. With continued strong sales and lean inventories, General Motors recently announced increases in both its production estimates for the first quarter and its sales forecast for the year. Domestic production of steel increased in January from very low levels. Steel inventories continued to fall, according to one industry analyst, and prices strengthened from very weak levels. New orders for construction and consumer equipment decreased considerably in the first quarter of 2002, but industry contacts noted that dealer sales were stronger than expected in January and February. Pending changes in environmental standards likely prompted the surge in new orders for heavy trucks in January. Several contacts indicated that more restrictive emission standards and heavy fines for noncompliance, scheduled to take effect October 1, would pull new orders ahead into the first three

quarters of this year. One contact with a large producer of telecommunications equipment suggested that there were more signs that the industry was "in the initial stages of a recovery," and noted that inventories were so low that restocking will take place even before a pickup in demand.

Banking/finance. Overall lending activity appeared to pick up modestly in January and February, with a few reports of firming demand for business loans. Buoyed by favorable mortgage interest rates, residential refinancing activity remained brisk, and contacts in some markets indicated that demand for new originations was picking up. Applications for home-equity loans and lines of credit were said to be increasing in some areas as well. Most contacts indicated that consumer delinquency rates were stable, and there was no discernible change in standards and terms for household loans. Reports of business loan demand were mixed, in contrast to the negative anecdotes of the past several months. Some bankers noted a "real pickup" in overall demand in January, while others said it remained soft. Even within the same major metro area, one contact reported a pickup in commercial real estate borrowing, as another said it was weaker. Industrial lending generally remained weak, but a contact with one large bank in central Indiana reported an increase in lending to manufacturers, who were investing in both inventories and capital equipment. Most lenders indicated that business loan quality stabilized somewhat in January and February, and banks that had been building their loan loss reserves were doing so at a slower rate.

Labor markets. Labor markets continued to slacken in the Seventh District, but most contacts indicated that the demand for labor was stabilizing. One industry analyst said that the number of mass layoffs had slowed, but idled workers were finding it more difficult to secure work. A contact with a large staffing agency said that total billable hours and revenues rose early in 2002, after sinking throughout 2001. This contact also noted that most of the company's regional managers, who at this time last year "saw no end in sight" to the industry's doldrums, expressed confidence in a rebound in the second half of this year. Contacts in some industries have said that the general economic slowdown has helped improve worker productivity as turnover rates have decreased and managers were learning to "manage better" during lean economic times. There were no new reports of intensifying pressure on wages, but contacts continued to express concern over rising health insurance costs.

Eighth District - St. Louis

Summary

Despite some bright spots, economic activity in the District continues to be weak. Retail sales in December and January were generally at or just below their level from a year earlier, although retailers are mildly optimistic about the upcoming months. The manufacturing sector has been mixed, with some industries continuing to face reduced orders while others have begun to recover. The residential real estate sector has picked up and remains relatively strong throughout most of the District. New housing permits continue to be issued at a higher level than a year earlier. Commercial real estate markets have continued to be stagnant throughout the District, with rising delinquencies in at least one area. Driven by rising real estate loans and loans to banks outside of the District, total loans outstanding at small- and medium-sized banks have risen significantly. Agricultural producers in the District anticipate reduced planted acreage for wheat and cotton in the upcoming year, although there is a great deal of uncertainty as farmers await the passage of the new farm bill.

Consumer Spending

Contacts report that retail sales in December and January were, on average, at or just below their year-earlier levels, and just under one-half noted that sales had been lower than expected while nearly as many noted that sales were higher than expected. Apparel, shoes, home entertainment and décor, health and beauty products, and seasonal items were strong sellers while jewelry, gift items, and collectibles moved more slowly. Despite a slow season, most contacts noted that inventories were at desired levels, while only 20 percent reported excess inventory. Contacts remain mildly optimistic about the next few months, with about one-half expecting slightly higher sales compared with the same period last year, while most of the rest expect the same level of sales.

Car dealers in the District report that sales in December were higher, on average, but have tapered off since the end of the year. Almost all contacts attribute this pattern to financing incentives and rebates offered by manufacturers on new cars, the most aggressive of which have ended recently. Several dealers reported that, because of ongoing rebate offers, new cars continue to sell better than used cars, causing

new-car inventories to be okay-to-low and used-car inventories to be okay-to-high. About one-half of the contacts noted higher rejection rates for finance applications, while the other half have seen no change.

Although individual responses about car sales in the next few months varied from very optimistic to very pessimistic, the average dealer was neither optimistic nor pessimistic.

Manufacturing and Other Business Activity

The District's manufacturing sector continues to be weak. Steel, fabric, apparel, paper, auto, oil and gas, and building supplies are among the industries facing reduced orders. Most manufacturers do not expect a turnaround until the second half of 2002. Despite the overall slowdown, a few District firms in the food, coal, energy, and ink industries have been expanding. Districtwide, contacts in the service sector continue to report business as being flat-to-slow compared with the same period last year. In order to cut costs, many firms have decreased advertising expenditures, although a few contacts in the advertising industry noted recovery in television advertising revenues. Contacts in the telecommunications industry are taking a "wait and see" attitude, expecting earnings to rise in the second half of 2002. The tourism industry continues to slow, as contacts in the hotel industry have been reporting a drop in occupancy rates, resulting in reduced profits and layoffs.

Real Estate and Construction

Residential real estate sales have picked up across most of the District, with the exception of northern Mississippi, where the number of homes for sale has risen to a historically high level. December 2001 year-to-date sales in northern Arkansas and Memphis improved over year-earlier levels. Residential sales in central Kentucky continue to do well given the time of the year. A contact in St. Louis reports that a rising quantity of bulk warehouse and general office space, falling rents, and falling absorption rates indicate a buyer's market for commercial real estate. Similarly, Memphis and Louisville finished the year with an excess of office and sublease space due to the failure of Internet businesses. Office-rent delinquencies for Class B and Class C properties in northern Arkansas are slightly higher than normal.

Residential construction opportunities continue to grow, as December year-to-date permit levels were higher than year-earlier levels in most of the District's metropolitan areas. Government-sponsored

construction opportunities remain strong in the Kentucky and Indiana portions of the District with the approval of projects for highway and bridge construction as well as projects for public facilities such as libraries and jails. Commercial contractors in Arkansas and western Tennessee report commercial building has been slow over the past few months, but they remain optimistic for 2002.

Banking and Finance

Total loans outstanding at a sample of small- and medium-sized District banks rose by 15.7 percent between late November last year and late January this year. This significant increase stems from an increase in real estate loans, which rose by 22.5 percent over the same period, and loans to other commercial banks in the rest of the country, which rose by 26.2 percent. Commercial and industrial loans and loans to individuals have also increased over the period, growing by 3.5 percent and 9 percent, respectively. Total deposits at these banks were 15 percent higher over the same period.

Contacts in central and northeastern Arkansas, and western Tennessee have reported strong loan demand, particularly for residential lending. Bankers in northeast Mississippi and western Tennessee reported high past-due loan ratios and high bankruptcy filings. Nonetheless, they consider themselves in a good position with high liquidity and loan loss reserves.

Agriculture and Natural Resources

Although crop prices generally remain below last year's levels, one contact reported that District agricultural land values rose by about 5.5 percent last year, with faster appreciation in the District's northern states. Despite more favorable planting weather last fall, District winter wheat producers reduced planted acreage by 7 percent, down 20 percent since 2000. A major survey of U.S. cotton farmers' 2002 planting intentions shows a modest decrease (-6.7%) in acreage from a year earlier. Based on survey results, farmers in the Mid-South region plan to decrease planted acreage by almost 20 percent. Cotton industry contacts report that large domestic and international supplies of cotton in the United States are expected to keep cotton prices relatively low in the foreseeable future. As the 2002 planting season fast approaches, contacts reported that they were uncertain about their crop plans for the year as farmers anxiously await the passage of the new farm bill in Washington.

NINTH DISTRICT--MINNEAPOLIS

Overall economic activity in the Ninth District appears to have edged up in recent months. Residential construction and mining activities are up slightly. The commercial construction, tourism and energy sectors have slowed. Meanwhile, the consumer spending, manufacturing and agriculture sectors are mixed. From early January to mid-February, labor markets loosened slightly, while overall wages and prices were stable. However, decreases in some construction materials prices and increases in home prices and insurance premiums were noted.

Construction and Real Estate

Commercial construction activity is soft. Contracts awarded for heavy construction projects decreased 22 percent in the three-month period ending in January compared with the same period last year. A representative of a commercial construction company said that the market has bottomed out in the Minneapolis-St. Paul area. Vacancy rates in the industrial markets of some Minneapolis suburbs are as high as 17 percent.

District home building is solid. Home permits in the Minneapolis-St. Paul area were up 7 percent in January compared with a year earlier, with strength particularly noted in multi-family construction. According to residential construction officials in Sioux Falls, S.D., home builders are expected to be busy in 2002, but the year is likely to finish somewhat slower than the previous two record-breaking years. A contractor in Bismarck, N.D., expects to build 25 percent more housing in 2002 compared with a year earlier. Bank directors reported that the outlook for residential construction is optimistic for the upcoming year, with softness noted in the high-end housing market in Montana.

Consumer Spending and Tourism

Consumer spending is mixed. A major Minneapolis-based department store retailer reported that overall same-store sales in January were up 6 percent compared with a year earlier. A Minneapolis area mall manager estimated that sales increased about 4 percent in February compared with a year ago. In North Dakota a mall manager expects February sales to finish up 3 percent to 5 percent compared with last year.

In contrast, a St. Paul area mall manager noted slightly less traffic in January and February compared with last year. A Helena branch bank director reported slow February traffic at a Montana mall compared with a year ago. A Minnesota-based leather products retailer said that same-store sales in January were down 17 percent compared with last

year. Auto sales in Minnesota slowed in January and February, according to a representative of an auto dealers association.

Little snowfall and warm weather has halted winter tourism activities in many areas. Some businesses in the Upper Peninsula of Michigan expect the season to be off as much as 40 percent to 50 percent due to poor snowmobiling conditions. A tourism official in South Dakota estimated ski activity down 45 percent and snowmobiling down 70 percent this year compared with a year ago. However, traffic at Mount Rushmore, considered a "fair weather" attraction, set monthly attendance records from October through January. A ski resort in Montana reported good snow conditions this year and an increase in visits over last year.

Manufacturing

Manufacturing activity is mixed. Preliminary results of a February survey of Minnesota manufacturers reveal that production in the first half of 2002 will be higher than the levels of the last half of 2001. However, a January survey of purchasing managers by Creighton University indicated slight decreases in manufacturing activity in Minnesota and South Dakota and slight increases in North Dakota. In Minnesota, a factory that produces industrial abrasives plans to severely curtail output. However, a data storage producer in North Dakota plans to expand output and employees this spring, and a new pasta plant is expected to begin production in April. In addition, a new dairy plant is scheduled in the Upper Peninsula of Michigan. A Montana steel producer plans to expand output to meet demand for a new short-distance rail line, according to a Helena bank director.

Mining and Energy

Activity in the energy sector is down somewhat, while mining is up slightly. Mid-February district oil and natural gas exploration and production levels were slightly behind the levels of early January. Meanwhile, the iron ore industry is up slightly in the first two months of this year compared with November and December of last year. Production at a large mine in northern Minnesota returned to more normal levels and another mine expects to resume production in March. Mining production is stable to up slightly in Montana, according to a state mining official.

Agriculture

Dry and warm weather conditions have favored livestock and dairy producers but have hampered crop producers. Livestock producers report little stress on their herds, due to the unseasonable warm weather across the district. Meanwhile, the Montana Agricultural Statistics Service reported that winter wheat producers are increasingly concerned about the lack of snow cover to protect from cold temperatures and gusty winds. Winter wheat snow cover was rated at 69 percent very poor, while wind damage was rated at 28 percent heavy. Freeze and drought damage was rated at 41 percent heavy.

Employment, Wages and Prices

Some layoff announcements were cited since the last report. A large computer maker will cut more than 500 positions at two South Dakota plants. A high-tech manufacturer announced job cuts that may include closing a St. Paul plant, affecting 86 workers. A Minnesota-based airline will cut 64 mechanics positions.

As a marker of looser labor markets, a Minnesota company recently reported a 70 percent acceptance rate of offers made to applicants for open positions, an increase from a historical average of 50 percent. Initial claims for unemployment insurance in Minnesota were up 28 percent in January compared with a year earlier, including a large increase in claims from the construction sector.

In contrast, a computer company is planning to hire 100 employees in North Dakota. Furthermore, U.S. Customs will add 39 jobs at North Dakota's border with Canada. A call center in northern Minnesota will add 65 more workers.

Wage increases are modest. St. Paul public school teachers recently agreed to a 2 percent increase in pay; the overall wage and benefit package was considered average compared with recent contracts, according to a union official. In contrast, according to the results of a December St. Cloud Area Quarterly Business Report survey, 55 percent of respondents in central Minnesota expect increases in employee compensation by June.

Price increases are moderate, with price decreases noted in some construction materials and increases in home prices and insurance rates. Recent steel and cement prices have decreased slightly from a year earlier. Meanwhile, the median price of homes recently sold in Minneapolis-St. Paul is up 12 percent compared with a year earlier. Some home insurance premiums during the past two months are 10 percent to 30 percent higher than last year in North Dakota, according to an official.

TENTH DISTRICT - KANSAS CITY

Overview. The Tenth District economy remained very sluggish in late January and February, but some small signs of improvement were reported. Manufacturing activity fell further, automobile sales and residential construction activity declined, and commercial real estate activity remained weak. On the positive side, however, retail sales excluding autos edged higher, home sales strengthened, and energy activity stabilized. In the farm economy, dry weather continued to hinder the development of the winter wheat crop. District labor markets remained considerably less tight than a year ago, and wage pressures were largely nonexistent. Retail prices and prices for construction materials were flat, while prices for several manufacturing materials edged lower.

Consumer Spending. Retail sales edged up in late January and February following a better than expected holiday season, and were above year-ago levels in most stores. High-end retailers, however, continued to report sluggish sales. Many retailers in Kansas, Oklahoma, and western Missouri lost sales when they were forced to close due to power outages caused by a late January ice storm. Home furnishing items continued to sell particularly well across the district. Nearly all retailers expect sales to increase in coming months. Inventory levels held steady, and most managers reported they were satisfied with their stocks. Most stores, however, expect to expand stock levels heading into the Easter season. Colorado ski resort operators reported that while activity has been below year-ago levels, it has not been as weak as they feared in the fall. Motor vehicle sales in the district continued to fall from the record sales seen late in 2001 and lot inventories were growing more quickly than some dealers preferred. Still, dealers were cautiously optimistic that sales would rebound by summer.

Manufacturing. District factory activity declined again, but optimism about future production continued to build. Production and orders fell farther below year-ago levels, and employment and capital expenditures showed little sign of improvement. Auto plants in the region experienced brief losses of production as a result of the late January ice storm. One plant expects to make up the lost

production sometime in March. On the positive side, an increasing percentage of district manufacturers expect a turnaround by mid-year. Inventory levels held steady after falling sharply over the past year, but are expected to resume declining in coming months. Some firms reported difficulties receiving steel shipments, but no other significant shortages of materials were reported or expected for the foreseeable future.

Real Estate and Construction. Home sales strengthened in most of the district, but residential construction activity declined in most district states, and commercial real estate markets remained very weak. Residential sales improved in most areas, with the exception of higher-end homes. However, inventories of unsold homes still remain high, and housing starts fell outside of Oklahoma and New Mexico. Most builders expect the sluggish activity to continue for several months. Commercial realtors continued to report weakness in most district office markets, especially in Denver. With absorption remaining slow, vacancies have continued to edge up, and were significantly higher than a year ago in February. Lease concessions such as rent abatement and moving allowances continued to be reported in some markets. However, realtors reported prices for office space were down only slightly, as most sellers are still in good financial position and expect the market to turn around once the economy recovers.

Banking. Bankers report that loans fell 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 held steady for home mortgages and edged up for home equity loans. Refinancing activity slowed but was described by some bankers as still strong. On the deposit side, demand deposits, NOW accounts, and money market deposit accounts all increased, while large CDs and small time deposits remained unchanged. Bankers attributed the increase in liquid deposit accounts to low market interest rates and a wait-and-see attitude by investors. All respondent banks reduced their prime lending rates, but most banks left their consumer lending rates unchanged. Lending standards were unchanged.

Energy. Energy activity in the district remained steady in late January and February. The region's count of active oil and gas drilling rigs stayed near the two-year low reached in late 2001. In Wyoming, higher coal prices have reportedly led to some expansion of mining activity and have intensified efforts to increase rail service from the Powder River Basin to coal markets.

Agriculture. Much of the district's winter wheat crop was in below-average condition due to dry weather. The dry weather has also limited grazing on district wheat fields, but other forages have been in ample supply for feeding cattle this winter. District farmers remained concerned about the weak farm economy and were hesitant to take on additional debt. District bankers, however, reported strong farm balance sheets with farmland values holding steady. To date, major problems in district farm loan portfolios have been avoided through government payments to farmers. Small business activity in rural areas remained sluggish and expectations point toward a slow recovery at best.

Wages and Prices. District labor markets remained considerably less tight than a year ago, but a slightly higher percentage of firms reported shortages of some kinds of workers than in the previous survey. Occupations experiencing shortages included welders, skilled construction trades, and nurses. There were also some tentative signs of increased demand for entry-level retail and service workers. Some hospitals reported expanding the use of nontraditional hiring incentives, including grocery allowances and housecleaning services, in an effort to attract nurses. Evidence of wage pressures outside the occupations experiencing shortages remained virtually nonexistent. Some firms reported they were delaying annual wage increases for six months or more. Many employers also continued to increase employees' share of health care costs. Retail prices largely held steady and are expected to remain flat in coming months. Prices for most manufacturing materials, including many plastics and paper products, have declined. Meanwhile, steel prices have risen somewhat and are expected to increase further. Prices for construction materials were basically flat, but many builders were concerned that prices for gypsum wallboard would increase in the near future.

ELEVENTH DISTRICT—DALLAS

Eleventh District economic activity remained weak in January and the first half of February. Retail sales improved some, but other service-sector activity continued to be sluggish, and manufacturing activity was weak. Construction and real estate activity continued to soften. Energy activity showed signs of bottoming out, but many contacts fear a collapse in natural gas prices could lead to future declines. Respondents in the financial services industry have lowered their expectations for loan demand, but note that consumer lending has held up better than expected. Agricultural conditions remained dry.

Prices and Labor Markets. There were some signs of increasing price pressures in the service sector, but prices were mostly unchanged or lower in the manufacturing and energy industries. Continued weak global demand and very warm weather in the United States have pushed down most energy prices despite stability in the price of crude. November 2001 through January 2002 was the second warmest ever recorded in the United States. Crude oil prices were pushed up to near \$20 per barrel in January after OPEC and non-OPEC countries reduced production. Some contacts expressed concern that if global demand does not pick up soon, OPEC unity will be tested severely and a price collapse could follow. U.S. crude inventories are 33 percent higher than last year, and heating oil inventories are 23 percent higher than a year ago. There is still too much petrochemical capacity, and downward pressure on prices continues. Chemical inventories are very low because customers expect prices to fall further. Warm weather has limited demand for natural gas and left storage facilities very full. Companies that hold natural gas in storage will not want to hold the gas over the summer, and many contacts expect serious downward pressure on natural gas prices in the Spring. Paper producers say that selling prices continue to fall because of excess capacity in the industry.

Many industries continue to report rising costs for all types of insurance. Security costs are also rising, particularly for the airline industry. Contacts in several industries note that stiff competition has prevented these cost increases from being passed along to consumers. While labor markets have loosened, many firms say competition remains stiff for quality workers and wages are increasing for those employees.

Manufacturing. Manufacturing activity remained weak. Producers of fabricated metals said demand continued to be very slow, while producers of primary metals, brick and tile

reported a drop in demand over the past 8 weeks. Paper producers say sales are still sluggish. One contact noted that a lot of manufacturing has moved offshore, reducing demand for packaging materials produced domestically. Demand for glass, cement and concrete and food products was unchanged. Apparel producers reported an increase in sales over the past 8 weeks, because retailers are restocking after clearing out inventories during Christmas. Still more layoffs were announced in the apparel industry as the industry continues to move to lower cost off shore locations.

The high tech industry reported that sales continued to bounce around the bottom of the cycle. While most respondents believe a recovery has begun, it is expected to be very slow. Demand for telecommunications products was still very weak, particularly in Europe, and sales of personal computers continued to be "anemic." Inventories are lean across high-tech industries, according to contacts.

Demand for petrochemicals and refined products remained weak. Some refineries have announced cuts in production while others have begun early turnarounds to produce gasoline for the spring and summer.

Services. Activity in the service sector continued to be sluggish, although there were some areas of improvement. Temporary service firms said that demand for workers remained down, particularly to supply manufacturing and light industrial positions. Demand was strong, however, for workers to staff administrative and clerical positions, the banking and retail industries, as well as some professional services. Legal contacts say transactional activity, particularly venture capital, is slower than a year ago, but other types of business activity is starting to improve. Litigation and bankruptcy work remained strong. Accounting firms say activity remained strong for auditing and taxes but consulting work had declined. Demand for transportation services was still weak, but is showing signs of slowly improving from the very depressed level a couple of months ago.

Retail Sales. Retail sales improved some in February from a very weak January. Contacts say this is a difficult time of year to infer trends from sales data and remain conservative with their purchases despite recent signs of a pick up. Retailers are happy that inventories have been drawn down. One contact explained that stronger than expected sales could result in a brief price spike which they would prefer to having too much inventory. Auto

sales have been solid and better than expected following the low interest rate deals from last year. Inventories are a little high and the average gross profit on auto sales is down.

Financial Services. Loan demand declined seasonally as expected at levels slightly lower than a year ago. While contacts have generally lowered their expectations for activity, they note that consumer lending has been stronger than expected. Commercial and industrial lending has been flat to moderately positive. Credit conditions are mostly unchanged, with only a couple of contacts reporting an increase in delinquencies. Credit standards remained stable since the last survey, according to contacts, and are not expected to change in the near future.

Construction and Real Estate. Activity remained weak over the past 8 weeks. There was a slight uptick in leasing activity in the Dallas area, stimulated by free rent and other incentives. Contacts say long-term leases are only being signed with deep financial concessions. Rents have declined 20 percent and are not expected to increase this year. The Houston market has been jolted by the sudden addition of substantial office space, leading to uncertainty about how low the occupancy rate could fall.

Residential activity is still weak, and potential homebuyers continue to back out of deals, according to contacts. Existing home inventories have risen as people continue to leave houses they can not afford. Demand for multifamily housing is also weak and concessions are prevalent. Demand remains solid, however, for lower priced homes.

Energy. U.S. drilling activity showed signs of bottoming out in recent weeks, but there are concerns about future declines. Some projects are being delayed and contacts say the possibility of a collapse in natural gas prices could lead to a decline of as many as 150 rigs. International drilling is also seeing some delays, although day-rates for rigs in the deep Gulf and key international markets continue to hold up well.

Agriculture. Overall conditions remained dry despite heavy precipitation in mid-February. Land preparation for corn and cotton is proceeding on schedule except in a few areas where producers had to wait for the ground to dry out. Despite low prices and a large surplus of cotton, farmers are continuing to plant as if it was a normal year. Ranchers are reducing livestock herds because dry conditions have prevented pastures from reaching their usual winter production levels.

TWELFTH DISTRICT-SAN FRANCISCO

Reports from Twelfth District contacts indicated a pickup in economic activity in January and early February. Respondents reported steady prices for most consumer goods and services and little pressure on wages. Consumer spending reportedly exceeded expectations in recent weeks and travel spending improved slightly, but sales remained below year-earlier values for both retailers and travel-related businesses. Demand for high-tech manufactured goods reportedly strengthened further in January and February, with contacts noting improvements in both sales and orders. District agricultural producers reported little change in conditions in recent weeks. Demand for low-to-medium priced residential real estate remained fairly strong, although slightly weaker than in previous months. In contrast, commercial real estate markets continued to weaken. Bank contacts reported a drop-off in borrowing in response to greater economic uncertainty and stricter loan terms.

Prices and wages

District contacts reported little change in consumer prices in the recent survey period but noted some downward pressure on input costs, especially energy. Falling input prices reportedly helped boost profit margins in a number of sectors. Ongoing weakness in labor markets further eased wage and salary pressures in the District during the most recent survey period. Wage increases were scant across sectors, and some contacts noted that some firms have suspended bonus programs until the economy improves.

Retail trade and services

District respondents reported better than expected retail sales in January and early February. Still, nominal sales growth reportedly remains flat to negative relative to a year

earlier. Contacts reported that retail inventories generally were in balance but that many retail outlets were cutting jobs to bring staffing in line with current requirements. Automobile sales slowed considerably relative to the fourth quarter of 2001 as many zero percent financing programs came to an end.

Respondents in the services sector noted that the demand for professional services such as financial counseling, advertising, and public relations fell in recent weeks. In contrast, demand for communications services reportedly improved in January and February. Travel and tourism also picked up slightly, although demand remained well below year-earlier levels, creating excess capacity at hotels, rental car agencies, airlines, and cruise ships.

Manufacturing

District contacts noted further signs of stabilization in the high-tech manufacturing sector, with improvements in new orders and sales and continued success in drawing down inventories.

Despite these positives, high-tech manufacturing contacts reported that firms continued to reduce employment.

Outside the high-tech sector, respondents reported little improvement, with falling orders and excess capacity continuing to depress output and earnings. Weakness was especially apparent in the District's aerospace sector, where the impact of reduced demand for air travel is beginning to show through to employment at aircraft and parts manufacturers. Numerous manufacturing contacts reported that the strong dollar and weak foreign economies continued to damp export demand for manufactured goods.

Agriculture and Resource-related Industries

District agricultural conditions reportedly changed little from the previous survey period,

with excess supply and low prices characterizing markets for most products. On a positive note, cattle farmers and growers of field crops worked down inventories, and saw improvements in prices. The long period of low prices reportedly has prompted producers of some products to engage in supply control programs. For example, prune growers reportedly have taken measures to reduce supply and stabilize prices. Several respondents noted that in the context of the strong dollar, there was increased competition from new global market players in South America, Northern Europe, and China. Lastly, respondents in the energy sector noted that warmer than normal weather has depressed demand for heating oil and natural gas and slowed growth in the fuel transportation business.

Real Estate and Construction

Conditions in real estate have remained mixed so far this year, with commercial markets weakening further and residential markets remaining stable. Respondents throughout the District noted further increases in vacancy rates and declines in lease rates for commercial property in recent weeks. Accordingly, construction on ongoing and new commercial projects slowed substantially, with many builders pausing until the economy improves.

In contrast, residential real estate markets in the District remained solid. Respondents noted that sales of low-to-median priced homes were strong, with many listed properties receiving multiple offers. In California, markets in the San Francisco Bay Area improved in January and February adding to ongoing strength in Southern California and the Central Valley. Across the District, the market for high-end homes remained weak, with sales and prices declining relative to the previous survey period.

Financial Institutions

District contacts reported that loan demand continued to fall on net in January and early February. Contacts noted that some of the drop-off in borrowing likely was due to the uncertain economic environment, while stricter borrowing requirements have priced some businesses out of the market. Respondents noted that consumer loans were more readily available with respect to price and loan terms than were business loans.