



April 21, 2004

## Summary of Commentary on Current Economic Conditions by Federal Reserve District

### Summary

Prepared at the Federal Reserve Bank of Minneapolis and based on information collected before April 12, 2004. This document summarized comments received from business and other contacts outside the Federal Reserve System and is not a commentary on the views of Federal Reserve officials.

Economic activity increased across the nation from mid-February through early April. The growth was widespread as retail sales moved up noticeably, and manufacturing, mining, energy, tourism and services all grew. In addition, new home construction is strong in a number of districts. However, commercial real estate markets remained soft. Lending activity increased and credit quality remained solid. Conditions in the agricultural sector improved overall with higher prices for most products. Meanwhile, labor markets tightened somewhat with modest wage increases. Many districts reported modest increases in overall consumer prices, but most districts indicated significant increases in numerous commodities and input products.

### Consumer Spending

Most districts saw a noticeable increase in retail sales. Boston, Cleveland and Philadelphia described sales as improving and strengthening, while sales were moderately above year-ago levels in the Atlanta, Minneapolis and St. Louis districts. Dallas, Kansas City, New York and San Francisco variously described consumer spending as brisk, solid or surprisingly strong. Meanwhile, retail sales growth moderated somewhat in the Richmond district, and consumer spending was somewhat mixed in the Chicago district. Several districts noted increases in apparel sales. Furthermore, many reports indicated that retail contacts were optimistic for growth during late spring and summer.

District reports indicated that vehicle sales were mixed. Minneapolis and San Francisco reported strong sales, and Cleveland, Kansas City, Philadelphia and Richmond described recent vehicle sales as rising or improved. However, some districts noted that sales were constant or down slightly from a year ago. In the Atlanta district auto sales were described as uneven, with strong demand for light trucks and SUVs contrasted with weakness in demand for cars. Chicago, Dallas and St. Louis suggested that automobile sales were soft or slow. A number of auto dealers indicated that inventories were higher than desired.

### Tourism and Services

Tourism activity grew in several districts. Atlanta, Minneapolis, New York, Richmond and San Francisco described tourism activity as brisk, solid or at high levels. In the northern part of the Boston district tourism picked up at a moderate pace after a slow start earlier in the year. Meanwhile, Kansas City said that travel and tourism were mixed, and Chicago

mentioned that leisure travel was generally flat. Boston, Kansas City, Minneapolis and Richmond indicated that tourism businesses were optimistic for the summer season.

Contacts in other service businesses also noted growth in activity. Chicago and Philadelphia mentioned that information technology firms noted increased demand. Trucking and shipping businesses in the Atlanta, Cleveland and Philadelphia districts reported an increase in activity. Meanwhile, transportation in the Dallas district was mixed, with demand for air travel up, railroads running at near capacity and trucking activity soft. Service providers in the San Francisco district saw further strengthening in demand. However, Richmond reported that customer demand for services, on balance, was flat.

### **Manufacturing**

Manufacturing activity increased in all the districts. New orders and production were up over a year ago. Several districts reported slow growth in capital equipment orders. Nearly all districts noted increased activity across a broad range of industry sectors, especially primary materials. Kansas City reported higher capacity utilization for most manufacturers. Most steel mills were operating at or near capacity in the Chicago and Cleveland districts. Philadelphia indicated that steel and iron supplies were limited. Orders for high-technology products increased in the Dallas and San Francisco districts. Rising material costs were a common theme across the nation, with mixed reports on the ability to pass costs along to consumers by raising prices.

### **Real Estate and Construction**

Commercial real estate markets remained soft. Most districts described conditions as remaining weak or activity as slow. The St. Louis bank said its commercial slump appears to have bottomed out. In contrast, the New York and San Francisco districts continued to see moderate growth in commercial real estate activity.

Residential markets were strong, with some concerns about the rising costs of building materials. Atlanta, Boston, Chicago, Kansas City, Minneapolis, New York and Richmond all suggested strong sales, but Richmond noted softening in the Carolinas offset by activity in other markets. Cleveland said sales were on par with the same period last year, and Dallas referred to scattered signs of improvement. Activity slowed in the St. Louis district. Several districts reported mid-priced homes accounted for most of the activity, with recent increased activity in the high-end market.

### **Agriculture**

Overall, agricultural conditions were good across the nation. Prices for most agricultural commodities remained strong. Chicago reported higher prices for corn, soybeans, hogs and beef, and Minneapolis noted record milk prices. Atlanta reported firm prices for vegetables, and San Francisco reported strong demand for nuts. Due to record prices, several districts indicated that farmers plan to plant more acres of soybeans this year. Atlanta, Kansas City and Minneapolis reported dry conditions in parts of their districts, and Richmond indicated that cold weather problems were hampering plantings.

### **Natural Resource Industries**

The energy and mining sectors remained strong. Most districts reported that high energy prices have fostered more exploration and production. Dallas saw growth in onshore drilling but noted continued decline in offshore activity. Kansas City reported an increase in the energy sector from already high levels and noted the increase in drilling has led to shortages of equipment and labor. San Francisco reported high capacity utilization for oil and natural gas extraction as well as electricity generation, with scattered capacity increases. Minneapolis reported oil and natural gas exploration and production increased from early February levels and also noted accelerated progress on wind generation and some other

energy projects. Meanwhile, firm prices and strong demand for minerals spurred production. Minneapolis noted iron ore mines continue to produce at capacity.

### **Labor Markets**

Most districts indicated that hiring increased moderately. Chicago and San Francisco also noted that more firms plan to hire later in the year. In the Dallas district, jobs increased for production workers in high tech, apparel and lumber manufacturing. A New York employment agency, specializing in office jobs, reported that the labor market has continued to strengthen in March and early April, with improvement described as moderate but broad-based. Meanwhile, reports of hiring remained mixed in Atlanta, but declines in some of the weaker sectors abated. Hiring increased for temporary workers in several districts.

### **Wages and Prices**

District reports show that increases in wages and salaries were modest; however, significant increases in the cost of health benefits were noted. In the Boston district, wages for retail positions were mostly steady, although some retailers were implementing increases of 3 to 4 percent. Salaries were relatively flat in the New York district. Overall wage increases were modest in the Minneapolis district, while health benefits remained a key issue in contract disputes. Dallas and Kansas City reported that wage increases were modest, but several employers noted that high benefit costs continued to discourage them from hiring new employees. San Francisco reported that employers have responded to the rising cost of health benefits in part by shifting some of the burden to workers.

Consumer price increases were generally modest, while district reports noted significant price increases in energy and several manufacturing and construction inputs. Kansas City indicated that most retailers described selling prices as flat and expected little change in prices going forward. Chicago and New York indicated that discounted or slowly declining retail prices were beginning to level off. Meanwhile, retailers in the Dallas district said they were beginning to have some pricing authority. Significant price increases mentioned in energy-related products included natural gas, oil and gasoline. In addition, significant increases in manufacturing and construction input prices included steel and other metals, plastics, cement, gypsum wallboard and lumber. Districts in which companies passed input price increases to customers included Atlanta, Chicago, Cleveland, Dallas and Kansas City. Retailers and manufacturers in Richmond were attempting to pass through higher input costs. Meanwhile, San Francisco indicated that the overall impact of higher production costs on final prices was limited, and contacts in St. Louis were reluctant to pass price increases to customers.

### **Banking and Finance**

Most Federal Reserve districts reported increased lending activity. Dallas, Kansas City, New York, Richmond and St. Louis all reported increases with Philadelphia and San Francisco reporting slow increases. Atlanta and Chicago reported flat overall demand, but Chicago noted stronger activity for small business and commercial real estate loans. Mortgage activity was up in Chicago, Cleveland, Kansas City and Richmond, held steady in New York, was mixed in Philadelphia and has slowed in Atlanta. Chicago, Dallas, New York and Philadelphia reported growth in consumer lending, while Cleveland reported flat activity.

Deposits were mixed and credit quality improved. Deposits were up in Kansas City and St. Louis, flat in Cleveland and Dallas and down in New York. Both Cleveland and Kansas City noted increases in liquid accounts and declines in certificates of deposit. Credit quality improved in Chicago, Cleveland and New York and was stable in Atlanta and San Francisco.

Boston reported slowly growing demand for insurance in the first quarter, especially for life insurance, and noted that more demand came from overseas than domestically. New York and Philadelphia both noted strong first quarters for securities firms.

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## First District--Boston

Economic activity is gaining momentum, according to business contacts in the First District. Most retailers and manufacturers report that sales and orders are ahead of year-earlier levels. Respondents in residential real estate and the insurance industry indicate that business continues at the high levels that characterized 2003. Contacts note increasing prices for metals, wood, energy, and other petroleum-related inputs, which some say they are able to pass on to customers.

### Retail and Tourism

Retailers in the First District report improving sales in late February and March of 2004. Although a March snowstorm hindered sales in the furniture sector, sales and traffic have reportedly improved this period from a year ago. Sales of big-ticket items, particularly office furniture, are said to be strong. Contacts in the lumber and hardware sectors report double-digit year-over-year increases compared with reduced sales in 2003 caused by unfavorable weather conditions. Compared with the preceding quarter, however, sales of lumber products are said to be up, while hardware products are down 10 percent.

Employment is flat according to respondents, with minimal seasonal hiring. Wages are mostly steady, although some retailers are implementing 3 percent to 4 percent annual increases. Most contacts report that inventories have increased slightly in the past couple of months. Rising costs for wood and metal products have raised selling prices in the lumber, hardware, and furniture sectors, but not hindered sales. Most gross margins are said to be holding steady. About two-thirds of respondents plan to keep capital spending flat in 2004, while the remaining retailers' plans are mixed.

Travel and tourism in northern New England is reportedly picking up at a moderate pace, after a slow start in the first quarter of 2004 because of cold and windy weather. According to contacts, advance bookings are strong for the upcoming summer, particularly for international travelers; they are expected to pick up further once airlines add several direct flights between Boston and Manchester, England in the second quarter.

All of the contacted retailers anticipate positive sales growth in the next three months, although many expect the rate of improvement to be weather dependent. While shoppers still seem to be cautious, contacts report that consumer confidence seems to be on the rise and feel that economic conditions are improving.

### Manufacturing and Related Services

Almost all First District contacts in manufacturing and related services report that sales and orders in the first quarter of 2004 were ahead of year-earlier levels. Growth was particularly strong for biopharmaceuticals, microelectronics products, and medical equipment. Durable goods manufacturers are pleased to see positive trends continuing, following a pickup in late 2003. Various other manufacturers indicate that the first quarter of 2004 marked an upturn, with particularly robust business recorded in March. Even the relatively few companies whose business has continued to lag year-earlier results are planning for a pickup before year-end.

Many contacts report sharp cost increases, especially for steel, energy, and petrochemical products such as polypropylene and polyester. Some manufacturers are experiencing supply problems with respect to steel and computer boards. Paper and packaging prices also are beginning to increase. Some businesses report that the cost increases are creating worrisome pressures on margins, while others indicate that customers are now willing to pay somewhat higher prices if justified by commodity cost inflation. Faced with competition, companies

across a wide range of industries view continued product innovation to be an important vehicle for maintaining steady to rising selling prices.

About one-half of the contacts in manufacturing and related services are increasing their U.S. headcounts, in most cases modestly. The remaining firms are either holding employment steady or finding ways to make modest cutbacks. Pay increases are expected to average 2.5 percent to 3.5 percent in 2004, while healthcare costs are continuing to rise substantially more. Most of the reported capital spending increases are oriented toward new product development and production (especially in the life sciences industry) as well as productivity improvements (including production equipment and information technology).

Businesses are mostly optimistic that demand for their products will keep increasing throughout the year. However, they also express some caution and uncertainty in the face of continuing geopolitical instability, the upcoming U.S. presidential election, and the possibility of rising interest rates.

### **Residential Real Estate**

Residential real estate markets are active throughout the New England region. In Massachusetts, the number of sales of both detached houses and condominiums rose modestly in January and February, following record volume increases in the fall. Some replenishment of depleted inventory has occurred. Sale prices of detached homes increased at an annual rate of approximately 7 percent, while condominium prices rose at a double-digit annual rate, stimulated by demand from first-time buyers and empty nesters, according to respondents. In the rest of New England, contacts report busy markets with seasonally rising levels of activity.

The inventory of entry-level housing stock remains limited throughout the region. Most contacts expect modest changes in the number of sales and in prices for the next quarter.

### **Insurance**

Demand for insurance grew slowly in the first quarter of 2004. Contacts selling life insurance report particularly strong increases, while sales of disability insurance grew only slightly and annuity sales were weak. Price increases for insurance products are moderating, which respondents attribute to increased competition. Demand growth in international markets was faster than in the United States.

Employment levels remained steady in the first quarter, but some companies expect declines later in the year through attrition or reorganization. Capital spending ranged from steady to strong, with some firms planning further increases in technology spending for expansion abroad, catch-up after a few years of deferral, or merger-related projects.

Respondents do not expect 2004 to be very different from 2003, but hope for higher interest rates, improved consumer confidence, and continued job growth. Worries about terrorism persist.

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## **Second District--New York**

The Second District's economy has gained momentum since the last report, with gradual improvement in the labor market and some signs of a pickup in price pressures. Retailers report that sales were ahead of plan in March, despite weak consumer confidence numbers and unseasonably cool weather. Recent business surveys point to continued strength in the manufacturing sector, along with widespread increases in input prices.

The housing market continues to show strength, particularly in the New York City area, and residential construction has begun to pick up, after being hampered by heavy rain and snow in January and early February. Manhattan's office market has continued to recover gradually, while its hotels and theaters have seen notable strength. New York's securities industry enjoyed an exceptionally strong first quarter, in terms of both revenues and profits, and firms are reported to be stepping up hiring. Finally, bankers report some pickup in loan demand and further declines in delinquency rates.

### **Consumer Spending**

Despite steady to weaker consumer survey results, retail sales were said to be brisk in March. Based on Siena College's survey of New York State residents, confidence was flat in March, following a pullback in February. At the same time, the Conference Board's survey covering residents of the Middle Atlantic states (NY, NJ, PA) residents showed confidence dipping another 4 points in March, following an 11-point drop in February.

Still, retailers report that sales were ahead of plan in March, as year-over-year same-store sales gains ranged from 5 percent to 12 percent. Most contacts note particular improvement in apparel sales, despite relatively cold weather. This strong performance, in the face of weak consumer confidence and the recent run-up in gasoline prices, has surprised some retail contacts. Most retailers describe inventories as relatively lean, with a lack of clearance merchandise translating into fewer markdowns. A number of retailers report that selling prices, which had been edging down over the past two years, have begun to level off. In general, retailers report little or no upward pressure on wages, but complaints persist about rising health care costs.

### **Construction and Real Estate**

Both home construction and residential real estate markets have been robust since the last report, particularly in New York City and northern New Jersey, though the rental market continued to lag. After a weather-induced slowdown in January, home construction activity bounced back in February and is said to have rebounded further in March. Year-to-date, single-family housing permits are running 3 percent ahead of 2003 levels, while multifamily permits are up 10 percent. Contacts in northern New Jersey's housing industry characterize the market as extremely tight, with a persistent shortage of homes on the market. They report that selling prices for both new and existing homes are up roughly 10 percent from a year earlier. The greatest concerns expressed by New Jersey homebuilders are a shortage of available land and a roughly 40 percent rise in lumber prices over the past year.

Similarly, a large Manhattan real estate firm reports that sales of co-ops and condos were brisk in the first quarter, and particularly in March, with a dwindling inventory of available units driving up prices and triggering numerous bidding wars. In contrast, the apartment rental market is reported to be slack, with inventories up from a year ago and rents steady but well below the peak levels of 2000.

Manhattan's office market showed some further modest improvement in March, ending the first quarter with its lowest vacancy rate in 1½ years, as brisk leasing activity more than offset additional sublease space coming onto the market. Also, the gradual upturn in asking rents continued in early 2004, though they are still more than 20 percent below their peaks of late 2000. Long Island's office vacancy rate fell more than a point in the first quarter, to 13.1 percent, but rents were flat.

### **Other Business Activity**

A major New York City employment agency, specializing in office jobs, reports that the labor market has continued to strengthen in March and early April, with improvement described as moderate but broad-based and demand for temporary workers picking up. Salaries are relatively flat--no longer being rolled back, but no noticeable increases either. A

contact in the securities industry reports that Wall Street firms posted exceptionally strong revenues and profits in the first quarter and are looking to ramp up hiring.

Manhattan hotels report that business was brisk in the first quarter, particularly in March, when revenue was reported to be up nearly 30 percent from a year earlier, reflecting a 16 percentage point jump in occupancy rates and a 5 percent rise in average room rates. Broadway also posted strong results for March: in the second half of the month, compared with a year earlier, theaters report a 17 percent increase in attendance and a 22 percent jump in box-office revenues. [Statistics for the first half of March are not comparable due to a strike in early March 2003.] Separately, a hike in New York City taxi fares will raise the cost of the average ride by 26 percent as of early May.

The district's manufacturers report further strength in business conditions in March and early April. Purchasing managers in both New York City and Buffalo areas continue to report widespread improvement in general business conditions in March, as well as upward cost pressures. Anecdotally, manufacturers across the District note ongoing improvement in new orders, production activity and hiring activity in late March and early April, along with intensifying price pressures.

### **Financial Developments**

Bankers at small to medium-sized banks in the Second District report an increase in demand for consumer loans and commercial and industrial loans, while demand for both residential and commercial mortgages held steady. Lower refinancing activity was reported by nearly two thirds of those surveyed, whereas demand for new home mortgages evidently strengthened. Credit standards in all loan categories remained virtually unchanged.

There was significant dispersion in the responses regarding the overall lending interest rates: decreases were reported by 37 percent of bankers, increases by 26 percent. On balance, rates on consumer loans and commercial mortgages were lower, while rates on residential mortgages and commercial and industrial loans were steady. Average deposit rates also decreased, on net. Finally, bankers report that delinquency rates were little changed for commercial and industrial borrowers but declined among other loan categories--particularly residential mortgages.

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### **Third District--Philadelphia**

Economic activity in the Third District expanded in March and the improving trend continued into April. Manufacturers reported increases in orders and shipments in March and further gains in early April. Retail sales of general merchandise in March were above the level of the prior year, and early April results indicated ongoing upward momentum. Auto and light truck sales rose from February to March but were lower than in March of last year. Bank lending has been moving up slowly in the past few weeks. Investment companies have been posting strong increases in business. Service sector firms reported growth, although the strength of the gains has been mixed.

The outlook in the Third District business community is generally optimistic, although the pace of improvement is not expected to pick up appreciably. Manufacturers forecast increases in shipments and orders during the next six months. Retailers anticipate a moderate increase in sales for the spring season compared with a year ago. Bankers expect business and consumer lending to increase, but have mixed views on the course of residential mortgage activity. Service companies anticipate continued moderate growth.



## **Manufacturing**

Third District manufacturers reported gains in activity in early April, maintaining the upward momentum from March. Nearly half of the manufacturing companies contacted said their orders and shipments were on the rise, and less than one-fifth said orders and shipments were declining. On balance, order backlogs at area plants leveled off in April after modest increases during the winter. Firms in all of the major manufacturing sectors in the region except transportation equipment generally indicated that business conditions were improving. Increases in demand were especially strong for firms producing lumber products, petroleum products, industrial materials, and metal products.

Manufacturing firms in the region continued to report rising prices in April. Goods whose prices were frequently mentioned as high or rising include natural gas, oil, steel and other metals, plastics, lumber, and various building materials. Additionally, several manufacturers indicated that steel and iron supplies are limited.

The region's manufacturers expect business activity to remain on an upward trend. More than half of the firms contacted for this report expect increases in shipments and orders, and less than one in five expect decreases during the next six months. Area manufacturing firms are scheduling increases in capital spending and are planning to add employees and extend working hours in the next six months.

## **Retail**

Third District retailers surveyed in early April generally reported that sales were rising compared with the sales of March and April of last year. Some merchants said cold and rainy weather at the start of April slowed the rate of sales growth, but the majority of retailers indicated a steady pace of growth in store traffic and sales. Some store executives noted that the average customer purchase has increased, and some reported that sales of luxury items have risen. Sales of spring apparel increased in line with merchants' plans, and sales of jewelry were also on the rise. Retailers generally described inventories as appropriate for the current sales rate, with most spring merchandise delivered. Some store executives said they were continuing to implement efficiencies in the supply chain that were permitting further reductions in delivery times and lower average inventory levels.

Third District retailers expect sales for the spring season to be above the same period last year. Most store executives said the gain will be moderate, but some have revised their forecasts up slightly. Several retailers noted that the costs of building maintenance and construction have begun to increase noticeably, although most reported that the costs of goods have been mostly steady.

Auto dealers reported a rise in sales in March from February, but a slight decline from March a year ago. Dealers indicated that sales of most foreign nameplates have been rising compared with domestic makes, although some imports appeared to be losing ground. Dealers generally expect sales to continue around the current rate for most of this year, but some are growing concerned that it will be difficult to maintain the high sales rate of the past several years.

## **Finance**

Outstanding loan volume at Third District banks was moving up slowly in April, according to banks contacted for this report. Commercial and industrial loans were on the rise as the credit needs of middle-market firms in the region have risen. Residential real estate lending continued on an upward trend. Consumer credit has been expanding, as well.

Bankers in the District generally expect lending to grow moderately this year, although some believe a slight pickup in the rate of growth is possible. They expect business lending to increase further, although several indicated that competition among lenders is limiting



loan income. Bankers expect consumer lending to expand also. Although demand for residential mortgage lending is currently high, bankers are uncertain that the recent pace of growth in mortgage lending will persist.

Investment companies in the District reported that cash inflows have been strong since the beginning of the year, and they expect high rates of investment by individual and institutional investors to continue through the rest of the year. Executives at investment companies said investor confidence appears to be rising, and that recent adverse publicity about some mutual funds does not appear to be damping the public's interest in stock and bond funds in general.

### **Services**

Most of the Third District service firms contacted in April reported improving business, although the scale of gains varied. Information technology firms have had some accelerating increases in activity. Contacts said system upgrades and maintenance, business applications, and information security measures have been the primary areas in which demand for information technology services has been growing. Among other business services, there has been an increase in consulting activity and very slight gains in building services and basic business support services. Trucking firms report steady growth in activity. Most service sector contacts expect business to continue to advance at around its current growth rate.

Temporary and permanent employment agencies in the region reported an increase in demand for workers since the winter months. The increase in hiring is coming in construction, trade, services, and finance. Placement offices at colleges and universities in the region reported that recruitment is up compared with last year. Industry sectors that are more active this year are finance, real estate, media, healthcare, information technology, and architectural services.

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## **Fourth District--Cleveland**

Business conditions continued to improve in the Fourth District, and the pace of improvement appears to have accelerated in recent weeks. More manufacturers reported expanded production in the last several weeks than earlier in the year, and most expect growth to continue in the months ahead. Steel producers continued to see strong demand. Retailers reported improved sales this spring. In the construction industry, residential builders continued to report strong sales, and conditions for commercial contractors appear to have improved in some areas of the District. District banks reported rising commercial loan demand and falling delinquency rates. Finally, shipping firms reported that activity continues to expand, at year-over-year rates on the order of 10 percent.

Despite these signs of improvement in the economic environment, the hiring plans of most firms remain modest. Reports of rising input prices that began earlier in the year became more widespread in recent weeks, and firms indicated that they have been more successful at passing these input-cost increases along to their end consumers.

### **Manufacturing**

For February and March 2004, a majority of manufacturers reported increases in month-over-month production levels. Domestic steel producers again reported robust orders in recent weeks, and many steel mills are said to be running at or close to capacity. Those firms that did not report an increase in production said that production levels stayed steady in the last eight weeks. This follows reports from earlier in the year in which production levels were characterized as flat for the majority of manufacturers over the first few weeks of

2004. More than half of those surveyed reported higher production levels than at this time last year. Most manufacturing firms expect modest growth in the months ahead.

Manufacturers' inventories remained at acceptable levels in recent weeks according to most contacts. However, some steel buying is said to be to supplement low levels of inventoried steel, as concerns about the availability of steel supplies intensify and production lead-times remain long. Manufacturers reported limited additions to their payrolls in the last several weeks. Nearly all manufacturers who sought new hires reported being able to find workers without difficulty and at no significant increase in wages. Any concerns about labor costs related mainly to rising health care and other benefits costs.

Rising materials costs, however, were a common theme from many manufacturing contacts, though these reports were more widespread among durable-goods producers. Prices reportedly rose in recent weeks for petroleum-based products and items such as steel and aluminum. Prices for both flat-rolled and structural steel have continued to rise in recent weeks. And as shortages persist, prices for scrap steel are still about twice what they were a year ago, though some reports suggested that these prices may have peaked in March. Several firms indicated that they had successfully raised their prices to compensate for these input-cost increases and indicated their intention to continue raising prices in order to offset additional increases in input costs.

### **Retail Sales**

District retailers reported that sales strengthened in recent weeks. Contacts attributed the improvement to strengthening consumer sentiment. Discount and department stores in the District reported that sales had increased from a year ago. This marks a departure for department stores, which had consistently reported sluggish sales in previous reports. Contacts at both discount and department stores anticipate that sales will continue to improve in the weeks ahead. Sales growth at specialty retailers was more varied: Apparel and personal care products reportedly sold well in recent weeks.

Some retailers noted that merchandise is being marked down less and promotions are being offered less often, while firms are said to be spending more on advertising. Contacts continued to characterize inventories as mostly flat on a year-over-year basis. There were no reports of significant wage changes; however, contacts continued to report rising health care costs.

The pace of automobile sales has risen slightly since the beginning of the year. Contacts attributed the improvement in part to the poor weather that persisted earlier this year. Nevertheless, sales in March were said to be similar to those from this time a year ago. Inventory levels reportedly remain high. Used car sales are said to be steady.

### **Construction**

Residential builders reported that sales rose in recent weeks, though some of this was attributed to seasonality. Several builders reported that starter homes continue to sell well. Sales growth so far in 2004 remains on a par with the pace of sales seen in 2003. However, rising materials costs remain a concern for many homebuilders; prices for lumber, plywood, drywall, and steel have reportedly risen significantly recently. Homebuilders have been able to offset these input-cost increases to a considerable extent by raising the prices to their customers, but are becoming concerned about additional cost increases.

For commercial builders, conditions appear to be improving in some areas of the District. Reports suggested that sales may be reviving in the Cleveland and Pittsburgh markets after a period of prolonged weakness. District-wide, however, conditions remain rather weak. Some contacts expect the economic environment to improve in the months ahead, reporting renewed customer interest. Of concern, however, are rising materials costs, particularly for

steel-related products. Commercial builders have been less successful than homebuilders at passing input-cost increases along to their customers.

### **Banking**

Commercial loan demand reportedly increased in March from the levels that prevailed earlier in the year. Real estate lending has been particularly strong recently. Consumer loan demand, by contrast, has been largely flat in the last two months. However, mortgage originations and refinancings are said to have revived recently. Core deposit growth was reportedly flat in recent weeks. Several institutions indicated that holdings in their most liquid instruments, such as savings and checking accounts, were increasing, while their certificate-of-deposit balances were declining because of low rates of return. Many contacts noted that delinquencies have declined in the past two months and are lower than in the first quarter of 2003.

### **Trucking and Shipping**

Trucking and shipping firms reported an increase in activity in recent weeks, continuing the upward trend from earlier in the year. Many contacts reported an increase in activity on the order of 10 percent relative to this time a year ago. Several firms reported that they are running their fleets near capacity. Firms are attempting to hire additional drivers, but it is reported that finding qualified drivers is difficult, and retaining drivers is difficult as well. Some carriers have changed operational procedures to try to offset increased costs stemming from the revised hours-of-service regulations that took effect in January. Firms are also replacing trucks in their fleets, partly in anticipation of scheduled changes in emissions standards. Rising fuel costs are a concern to many carriers, but firms have generally been able to pass along these increased costs to customers through surcharges.

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## **Fifth District--Richmond**

The Fifth District economy continued to expand at a moderate pace in March and early April, as stronger growth in manufacturing activity was tempered by slower growth in the services sector. Manufacturers posted strong gains in shipments and new orders in March, suggesting an end to the prolonged downturn in the sector. In contrast, services businesses and retailers reported a slowdown in demand and only a limited expansion of payrolls. In commercial real estate, office and industrial leasing was flat in most areas, although a pickup in retail leasing occurred in the Washington, D.C. area. Home prices rose and sales remained exceptionally strong in Maryland and Virginia, but weakened somewhat in the Carolinas. In the financial sector, residential mortgage lending was boosted by a dip in mortgage interest rates in February and March and contacts noted more interest in business borrowing to finance capital spending. District labor markets exhibited modest job gains in the manufacturing and services sectors. Some upward price pressures were in evidence as retailers and manufacturers reported that they were attempting to pass through some higher costs of raw materials. In agriculture, planting and crop development was hampered in some areas by colder than normal weather and dry soil conditions.

### **Retail**

Retail sales growth moderated somewhat in the weeks since our last report. Contacts at department stores in Annapolis and Columbia, Md., reported only modest sales growth, while those in central North Carolina and Virginia Beach, Va., said sales growth remained constant. Automobile dealers in Virginia and the Carolinas generally reported constant or higher sales growth. Building and garden supply stores said sales remained on pace, but contacts noted that higher prices for lumber and steel were leading them to raise retail prices in some cases. A few retail businesses said they had hired additional employees and average wages moved moderately higher. Looking ahead, most contacts remained optimistic

regarding the prospects for retail sales. However, a contact said the Richmond metropolitan area was oversaturated with retail businesses as a result of two regional malls opening six months ago; he expected a retail shakeout over the next year.

### **Services**

On balance, customer demand at services firms was nearly flat in March and early April. Medical and surgical services providers in central North Carolina reported a slight pickup in demand, but those in central and northern Virginia said demand declined. A freight service firm in North Carolina also reported higher demand, while another in Washington, D.C., said business was off. Fitness centers in Washington, D.C., and Charlotte, N.C., reported that demand for their services increased, particularly for "add-ons" such as personal trainers. A caterer in Washington, D.C., told us business was steady over recent weeks, but business clients were requesting fewer galas as a result of smaller budgets.

### **Manufacturing**

District manufacturing activity expanded at a solid pace in March as shipments and new orders strengthened appreciably in the food, paper, printing, and primary metal industries. A Maryland-based producer of electrical equipment told us that new orders from Japan and China continued to be unusually strong. Several plastics manufacturers said that business was looking a little better but they were not convinced that the increase in activity would continue. Manufacturing employment edged slightly higher while the average workweek picked up considerably. Raw material prices continued to move upward; a textile manufacturer in North Carolina said Chinese firms were buying up raw materials--cotton, paper, steel and petroleum--and bidding prices higher. A primary metal manufacturer in Maryland expressed a similar sentiment, noting that his company would be unable to maintain its existing prices because sharp increases in prices for stainless steel and copper-based alloys had raised their costs.

### **Finance**

District bankers reported moderately higher growth in loan demand in recent weeks. Demand for commercial lending was reportedly stimulated by a general pickup in the economy; one District lender described business clients as finally "coming out of their shells" and borrowing to finance capital spending. A commercial lender in Charlottesville, Va., said that his office had been busy, in part because he was "pounding the pavement" for loans. A contact in Richmond, Va., reported stronger lending activity but noted that her bank had been "pricing thinner" to gain more business. Residential mortgage lending was bolstered by a drop in mortgage interest rates in February and March. One District banker, however, noted that mortgage lending was starting to ease again as mortgage interest rate rates edged upward in April.

### **Real Estate**

Realtors continued to report generally strong housing markets in the Fifth District. The Washington, D.C., market remained very active; condominiums and co-op properties were selling particularly well, according to an agent there. Strength was also reported in Odenton, Md., where homebuyers were said to be "fighting over houses." A realtor in Virginia Beach said sales were very good and that buyers were "overpaying for properties," while a Richmond, Va., contact said his office registered a record number of sales in March. In contrast, a few markets in the Carolinas softened--an agent in Charlotte, N.C., said home sales were down from a year ago, while an agent in Greenville, S.C., reported "some slowness" in February. Home prices in most areas of the District continued to climb.

Fifth District commercial realtors reported little change in leasing activity during recent weeks. Realtors in the Washington, D.C., metropolitan area remained very busy, while contacts in Raleigh, N.C., and Baltimore, Md., characterized leasing activity as "status quo." By sector, office and industrial leasing was generally flat, but retail leasing was particularly

strong, especially in the Washington, D.C., market. Another bright spot was Greenville, S.C., where contacts were "very encouraged" by increased activity in all market categories during the last ninety days. Office and retail rents firmed up in the Washington, D.C., metro area and realtors in all markets reported that landlord concessions were slowing.

### **Tourism**

Tourist activity advanced again in March and early April. Mountain resorts in Virginia and West Virginia concluded a good ski season and contacts anticipated strong spring and summer bookings. Coastal tourism also strengthened. A contact in Myrtle Beach, S.C., said that bookings and walk-up traffic boosted business there in recent weeks. In Washington, D.C., officials said that tourism this spring was returning to pre-September 11th levels.

### **Temporary Employment**

Contacts at temporary employment agencies in the District generally reported modest increases in demand for temporary workers since our last report. Agents expected the economy to firm further in coming months and anticipated the demand for workers to strengthen as a result. Clerks, customer service agents, and IT personnel were among the temporary workers in greatest demand.

### **Agriculture**

Colder-than-normal temperatures in March and early April slowed planting and crop development in many areas of the District. Cold weather delayed tobacco transplanting in North Carolina and hampered cotton planting in South Carolina. Despite some rain in recent weeks, dry soil conditions persisted in many areas in Virginia and the Carolinas. Small grain producers in North Carolina said many fields have had less than an inch of rain since topdressing was applied.

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## **Sixth District--Atlanta**

Business activity in the Sixth District expanded at a moderate pace during February and March. Reports of hiring remained mixed, but declines in some of the weaker sectors abated. Retail reports indicated that sales exceeded year-ago levels, whereas auto sales were described as uneven. Tourism reports were distinctly upbeat. Single-family housing markets remained robust and small improvements were noted in some commercial real estate segments. Manufacturing output increased from low levels and transportation contacts continued to report increasing demand. Banking activity was described as mixed. Rising prices for some key transportation, manufacturing, and construction inputs were widespread, although instances where these increases were being passed on to final users remained limited.

### **Consumer Spending**

District retail contacts reported that February sales were up strongly compared with a year-ago, followed by moderate increases in March. Most merchants indicated that inventories were balanced. Women's and children's apparel, and shoes sold well in March. Home-related sales were mixed. Retailers remained upbeat and anticipate that second-quarter sales will also exceed year-ago levels. Demand for light trucks and SUVs continued strong, and contrasted with the weaknesses noted in most car segments even with strong marketing incentives.

### **Real Estate**

District single-family housing markets remained robust overall in February and March. The majority of Realtor contacts noted that sales exceeded year-ago levels, and most builders reported that new home construction during March met or exceeded the prior year's level.

The strong demand for mid-priced homes continued, with some improvement in demand for high-end homes. Demand continued to outstrip supply in several Florida markets. Housing inventories were mostly described as balanced elsewhere. Contacts anticipate continued strength in the second quarter.

Reports indicated there were modest improvements in commercial real estate markets in February and March. Several retail expansions were underway, and although most large-scale construction plans have remained on hold in other sectors, some small to mid-size projects have moved forward. Concern that escalating steel prices could hold up some projects was noted. Office markets remained generally weak.

### **Manufacturing**

Activity improved in several manufacturing industries. Strong sales in February and March were reported from lumber, plywood, metal piping, heavy trucks and trailers, and supply boats for the offshore drilling industry. Carpet production was described as steady, but other areas of the textile industry remained weak. The pulp and paper industry also continued to struggle with overcapacity problems. Some manufacturers reported increased steel product inventories as a hedge against additional price increases.

### **Transportation**

District transportation contacts reported continued strong demand for air, truck and rail transportation services. Inter-modal centers in Atlanta and Huntsville reported record volumes of rail cargo processed. Several District trucking companies reported very strong demand for both industrial and consumer shipments.

### **Tourism and Business Travel**

Contacts in the District's tourism and hospitality industry reported high levels of activity in several markets. South Florida recorded near record numbers of visitors, and hotel occupancy rates in central Florida were up from last year. Passenger traffic and fares were said to be increasing in the cruise industry. Gaming revenues along Mississippi's Gulf Coast increased strongly from a year earlier.

### **Financial**

Responses indicated that banking sector activity was mixed in February and March. Residential mortgage activity slowed somewhat, but there were some reports of new rounds of refinancing. Reports also noted increased use of adjustable rate mortgages. Demand for new commercial and industrial bank loans remained flat. Past dues and loan losses continued at low levels and competition for deposits was vigorous. One report noted a modest increase in venture capital activity in the District.

### **Employment and Prices**

Most reports indicated that hiring remained limited in March. Despite increased output, there were only scattered reports of new hiring in the manufacturing sector. There was a pickup in hiring because of new contracts in the defense industry. Contacts noted that the use of temporary workers was increasing in some sectors.

More instances of higher input prices were noted in March. One building contractor reported that the price of building materials was "going through the roof." In some cases, rising building costs were being reflected in new home prices. Sharply higher raw steel prices had increased costs for metal fabricators in the District. Some transportation firms indicated that they were able to pass on recent fuel costs increases. A large paper producer announced price increases for several consumer products.

### **Agriculture**

Dry weather conditions were the main factor affecting District farmers during late March

and early April. Recent market conditions for regional crops such as cotton and soybeans were bright. Vegetable prices were also firm. Overproduction of sugar was noted as a concern of District sugar cane growers.

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## **Seventh District--Chicago**

The Seventh District economy continued to expand in March and early April, with reports suggesting that gains were more widespread than during the previous Beige Book period. Contacts suggested that both consumer and business spending continued to improve modestly. Hiring generally remained subdued, though there were scattered reports of firming labor demand. Overall construction and real estate activity remained strong. Manufacturing continued to expand solidly. Lending activity generally picked up slightly. Prices appeared to be firming at both the producer and retail levels, though there were no new reports of upward pressure on wages and other labor costs. The situation for farmers continued to improve, as agricultural prices generally rose and field conditions were favorable for spring planting in almost all of the District.

### **Consumer spending**

Reports on consumer spending were again somewhat mixed, but suggested further improvement in March and early April. A contact with one national department store chain said that sales gains so far this fiscal year were in the low double digits, above their expectations. These gains were driven primarily by strong sales of home-related items as well as a notable pickup in women's apparel and accessory sales. Moreover, a large regional discounter said that food and other nondurables were selling well. Consumers were also said to be more responsive to advertising. On balance, merchants said that inventories remained lean. March theater ticket sales were up from a year earlier, according to one contact, due in part to some highly anticipated movie releases. Light vehicle sales in the District were somewhat soft again in March and early April, despite increased consumer incentives. Some dealers said that inventories were higher than desired, and they were cutting back orders for new vehicles. Contacts in tourism said that leisure travel in the region was generally flat.

### **Business spending**

Overall business spending continued to firm modestly in March and early April. A contact with one large technology firm said the improving economic environment led Information Technology managers to raise their forecasts for equipment and software spending in 2004. Some retailers have boosted their expansion plans for the year. However, contacts suggested that business travel remained relatively weak. A contact with one staffing services firm noted that new orders from manufacturers picked up sharply in recent weeks, particularly in the skilled trades. There were scattered reports of new permanent full-time hiring, and more firms indicated that they plan to hire later in the year. Still, much of the actual new hiring so far appears to be temporary, seasonal, or part-time. According to several contacts, many firms still lack enough confidence in the expansion's sustainability to increase their permanent workforces.

### **Construction and real estate**

Overall construction and real estate activity remained strong, buoyed by low interest rates and improving economic conditions. Existing home sales were again robust in most areas, with one Chicago-area Realtor adding that some homes in the ultra-luxury market were "starting to move, after sitting on the market for quite a while." New home sales and permits were strong as well, although some contacts said that the upper end of the new home market remained soft. Realtors and builders alike appeared more optimistic about home sales in 2004 than they had been during our previous reporting period. Nonresidential activity was still sluggish, although there were scattered reports of improvement. Much of the new



activity was reported to be in the light industrial, retail, and infrastructure segments. Although office leasing picked up slightly, the market remained soft and many contacts suggested it will remain so in the foreseeable future. One contact said that with weak job creation and an abundance of available space, office rents were generally flat, and landlords were "beating each other up to get a lease signed."

### **Manufacturing**

Manufacturing activity continued to expand solidly in the District. Contacts in a wider array of key industry segments reported stronger new orders, shipments, and backlogs while inventories remained generally lean. One steelmaker described demand as "still very hot," adding that his firm was running at capacity and turning down some new orders. In turn, a heavy equipment manufacturer noted that production was being limited somewhat by shortages of materials, particularly steel. This contact also said that new orders and backlogs in March were up considerably from a year ago, due in part to continued strength in construction and a rebound in some mining industries. Producers of cement and gypsum wallboard also cited the active construction market as contributing to strong new orders and shipments. Automakers noted that light vehicle demand continued to firm nationally in March, though inventories were still somewhat elevated. However, automakers have not altered second-quarter production plans because they expect sales to pick up.

### **Banking and finance**

On balance, lending activity picked up slightly in recent weeks. On the consumer side, one lender reported that credit card volumes were trending up in March and early April. Applications for residential mortgages rose in March; many bankers said that new originations remained strong into early April, while refinancing subsided after a "mini boomlet" in March. Consumer credit quality generally continued to improve and there were no changes reported in standards and terms for household loans. Business loan volumes were again relatively flat, well below most bankers' expectations. Many lenders said that their customers' cash flows were improving, and that firms were using that cash to meet their short-term liquidity needs rather than borrowing. Demand for small business and commercial real estate loans appeared stronger than for other types of loans. Business credit quality continued to improve modestly, and there were no discernible changes in covenants and/or collateral requirements.

### **Prices and costs**

Reports of firming prices were more frequent in March and early April. Apart from auto dealers, retailers generally indicated they were using less discounting to move merchandise than a year ago. Some materials prices (such as for steel, cement, and gypsum wallboard) increased notably in March. Many contacts suggested that domestic inventories of some materials were very lean, and the availability of low-priced foreign product was limited by a weaker dollar and sharply higher freight rates. At the producer level, manufacturers were largely successful in passing materials cost increases through to their customers. There were no reports of new upward pressures on wages and other labor costs.

### **Agriculture**

Agricultural conditions improved again this reporting period. Agricultural prices for corn, soybeans, milk, hogs, and beef generally were higher. Most farmers have sold their stored crops, generating higher farm income that has contributed to an increase in overall spending in rural communities. Sales of both new and used farm equipment have increased, especially smaller items at auction. With spring planting beginning, ground moisture levels were reported to be abundant in most of the District, with only a few areas facing inadequate subsoil moisture. Contacts reported that planting intentions had shifted, with more acres expected to be allocated to corn and fewer to soybeans. This shift was due to recent relative price changes as well as expectations for higher soybean yields resulting from planting

soybeans every third year rather than alternating every year with corn. With most farmers applying fertilizer in the fall, energy price increases have not had a large impact yet. Land values and cash rents of agricultural land moved upward again, leading to speculation that some leases will be renegotiated this summer.

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## **Eighth District--St. Louis**

Business activity in the Eighth District continued to expand slowly since our previous report. Still, some contacts in the manufacturing sector announced plant closings and downsizing. Retail sales increased slightly in January and February over year-earlier levels. Car sales were flat-to-down over the same period. Home sales slowed in some areas of the District, but commercial real estate markets appear to have stabilized. Total loans at a sample of small and mid-sized District banks increased between early January and mid-March, a slight improvement over the past few months.

### **Manufacturing and Other Business Activity**

The Eighth District's manufacturing sector continues to show signs of improvement. Contacts in the aerospace, automotive, and biopharmaceutical industries report plant openings, expansions, and new jobs. Despite expansion in some areas, there have also been announcements of plant closings and downsizing in the District. Affected industries include textiles, electronic equipment, commercial building appliance, and music publishing. Contacts throughout the District are concerned about rising steel prices. While some contacts are attempting to re-negotiate prices with existing clients, many are reluctant to pass price increases onto customers. In the services sector, firms in the health, transportation, and financial industries report improvements in business activity and plans for expansion. Contacts also report that the price of transportation services has increased, in part due to increasing fuel prices and in part due to recent legislation limiting the amount of time a driver can be on the road without resting.

General retail sales in the District improved slightly in January and February compared with the same months last year. Many retailers cited early tax refunds as one reason for improved sales. Strong-selling products included clothing, discount items, hardware, seasonal gift items, and new and used farm equipment. Auto dealers report flat or decreased sales, despite zero percent financing and incentives. Auto dealers report that inventory levels are much higher than desired. Contacts are hopeful that sales will improve throughout the rest of the year.

### **Real Estate and Construction**

Home sales have slowed down in some areas of the Eighth District. February year-to-date sales have fallen in the greater St. Louis and Louisville areas compared with February 2003. St. Louis had a decrease of 2.6 percent and Louisville of 10.0 percent. Memphis year-to-date sales were 8.5 percent higher in February than a year earlier, and contacts expect this trend to continue throughout the spring. Residential construction is still doing well in most of the District, with February year-to-date permits for single-family homes up in all of the District's metropolitan areas. Construction has been very active in northeastern Arkansas, and contacts are optimistic about the first half of 2004. February year-to-date permit levels increased by 4.6 percent in the greater St. Louis area. One exception is western Tennessee, where residential construction has yet to improve.

Contacts in the District indicate that the commercial real estate market appears to have bottomed out. The industrial and office markets have remained soft in Louisville, where fourth-quarter vacancy rates were slightly higher than 2002 year-end rates. The fourth-quarter industrial vacancy rate in Memphis increased to 23.9 percent, about 1 percentage

point higher than the previous quarter. Commercial construction has started to pick up in most of the District. Both private and government construction have remained steady in southern Indiana. Construction has increased during February in western Tennessee, particularly in the Jackson area. There are several projects underway in central and south-central Kentucky, such as the construction of new elementary and middle schools in Jamestown, Kentucky.

### **Banking and Finance**

Total loans outstanding at a sample of small and mid-sized District banks were up by 2.1 percent between early January and mid-March. This increase stems from a 2.5 percent increase in commercial and industrial loans and a 3.0 percent increase in real estate loans. Over the same period, loans to individuals, loans to commercial banks, and a grouping of all other loans declined by 0.3, 16.3, and 5.5 percent, respectively. At the same time, total deposits at these banks showed an increase of 3.2 percent.

### **Agriculture and Natural Resources**

Corn planting is well under way in Arkansas, Mississippi, and Tennessee, but it is only in the beginning stages in the other states. A small portion of the soybean, sorghum, and rice crops has already been planted as well. Farmers expect to plant 1 percent fewer acres of corn and 10 percent fewer acres of sorghum this year than in 2003. In contrast, they anticipate planting 2 percent more acres of soybeans than last year and at least the same number of acres of cotton, tobacco, and rice as in 2003. This year's total winter wheat acreage increased by 7 percent and is rated at 65 percent or more in good or excellent condition in every District state. The latest ratings for soil moisture and pasture conditions are good throughout the District, except in Mississippi. Livestock remains mostly in good condition, and prices received for beef cattle in mid-March are showing signs of a rebound after recent declines.

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## **Ninth District--Minneapolis**

From late February through mid-April, the overall Ninth District economy demonstrated solid growth. Residential real estate, manufacturing, agriculture, consumer spending, mining, energy and tourism were up, while commercial real estate activity was slow. District employment grew slightly. Wage increases and overall price increases for consumer goods were modest; however, significant increases were noted in a number of manufacturing and construction inputs and commodities.

### **Construction and Real Estate**

Commercial construction was generally slow. Contracts awarded for large construction projects in Minnesota and the Dakotas were down 1 percent for the three-month period ended in February compared with a year ago. The value of permits for commercial construction projects for the first three months of 2004 in Billings, Mont., were down compared with the same period last year, but the number of permits was up slightly. With recent vacancy rates at about 20 percent, rental rates in several downtown Minneapolis office buildings are more than 15 percent lower than five years ago. In contrast, a company plans to expand into as much as 100,000 square feet of additional office space in downtown Minneapolis, the largest office space absorption in some time, according to a commercial real estate company. Furthermore, a real estate developer noted increased activity in industrial building on speculation in the Minneapolis-St. Paul area.

In contrast to commercial construction, residential real estate activity generally grew. Home sales activity was brisk in February and March in the Minneapolis-St. Paul area, according to a representative of a realtors association. Home closings increased almost 2 percent in

Billings, Mont., during February compared with a year ago. Housing units authorized in district states; however, were down 4 percent for the three-month period ended in February compared with a year ago. In addition, recent apartment vacancy rates in Sioux Falls, S.D., reached 10 percent.

### **Consumer Spending and Tourism**

Overall consumer spending increased moderately. A major Minneapolis-based retailer reported same-store sales during March were 7 percent higher than a year ago. Traffic in February and March was up about 6 percent at a South Dakota mall compared with last year. February same-store sales at a North Dakota mall were up 2 percent to 3 percent compared with a year ago. Two Minneapolis area mall managers reported that same-store sales were up about 10 percent for February compared with a year ago and reported optimism for spring and summer sales.

Auto sales were up in February after a very slow January, while sales in March were strong, according to a Minnesota auto dealer.

Winter tourism finished the year sturdily in many parts of the district. Snowmobiling and cross country skiing activity was well above year-ago levels and ran late into the season in northwestern Wisconsin, according to a chamber of commerce official. Convention bookings in Duluth, Minn., were recently reported up by 25 percent in 2004. However, winter use of Yellowstone National Park was down 18 percent, primarily due to issues regarding snowmobile regulations. Tourism officials and resort owners are optimistic for a healthy summer season in northern Minnesota.

### **Manufacturing**

Manufacturing activity increased. A March survey of purchasing managers by Creighton University (Omaha, Neb.) indicated robust growth in manufacturing activity in the Dakotas and Minnesota. Several Minnesota manufacturers noted strong demand and have added work shifts, employees and machines. A new beef processing plant is planned for South Dakota. A hydraulic machinery fabricator in western Wisconsin plans a major expansion. In Montana, a linerboard facility, formerly at risk of closing, will remain open due to increased demand. However, in Minnesota, an industrial baking equipment manufacturer reduced production due to low orders, and an ammunition plant will shut down and move production to a facility outside the district. In western Wisconsin, an industrial automation company will close a plant and move production to other facilities in the United States.

### **Energy and Mining**

Activity in the energy and mining sectors increased. Late March district oil and natural gas exploration and production amounts increased from early February levels. In addition, progress on several wind-energy and other energy projects has accelerated. Meanwhile, prices for most major district mining commodities remain strong. District iron ore mines continue to produce at capacity and "can't make pellets fast enough," said an iron mining official. In Montana a mining official noted that the higher mining commodity prices "have increased the health of the existing companies, but as yet we have not seen this transition into significant exploration."

### **Agriculture**

Agricultural conditions are positive. Prices remained robust for most district agricultural commodities. The U.S. Department of Agriculture reported that mid-March prices for livestock, corn and soybeans increased significantly from February. Dairy producers in Wisconsin expected record prices for their milk in March. District farmers intend to plant more acres of soybeans and fewer acres of wheat in 2004 compared with 2003. Even though the western part of Montana still faces extreme drought, late winter and early spring storms reduced drought pressures across most of the district. Calving and lambing are on schedule.

About 40 percent of the winter wheat crop in Montana and South Dakota is rated good or excellent.

### **Employment, Wages and Prices**

Employment increased slightly since the last report with signs of future increases. Nonfarm employment increased 0.9 percent in February compared with a year earlier, the fastest year-over-year rate of growth since January 2001. In South Dakota, a trailer manufacturer plans to create up to 35 jobs beginning this spring and the aforementioned beef processing plant is expected to eventually create 300 jobs. A temporary staffing agency survey showed that 32 percent of employers in Minneapolis-St. Paul expect to hire more workers during the second quarter of 2004 and 1 percent expect to reduce payrolls. Last year 18 percent expected to increase payrolls and 7 percent planned reductions. A nursing shortage was reported in several areas of the district.

In contrast, in Minnesota an energy company recently announced plans to reduce staff by 100 employees at its headquarters, and a retirement services company will layoff 100 employees due to consolidation. Recent announcements of closings and lay-offs in Eau Claire, Wis., will likely result in about 600 job losses.

Overall wage increases were modest, while health benefits remained a key issue in contract disputes. During March and early April, over 2,000 bus workers were on strike in the Minneapolis-St. Paul area, primarily over retiree health benefits. Meanwhile, employment officials noted upward pressure on wages in Bozeman, Mont., due to the low unemployment rate (2.9 percent).

Overall price increases for consumer goods were modest, while significant increases were noted in a number of manufacturing and construction inputs and commodities. Helena bank directors noted that recent price increases were generally moderate. The Billings, Mont., area consumer price index increased 0.3 percent in February from January. Meanwhile, news reports and bank directors noted significant price increases in several manufacturing and building materials, including steel, copper, aluminum and lumber. Gasoline prices in Minnesota for the week of March 29 were up 13 percent from a year ago. Prices received by North Dakota farmers for agricultural products were up 10 percent in March compared with the same month last year.

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### **Tenth District--Kansas City**

The Tenth District economy expanded solidly in March and early April. Retail sales increased, manufacturing activity continued to grow, and labor markets showed further improvement. In addition, housing and energy activity rose from already high levels. Agricultural conditions were little changed from the previous survey, while commercial real estate markets were still generally weak. Wage and retail price increases remained modest, but more manufacturers than in past surveys were raising their output prices.

### **Consumer Spending**

Consumer spending in the district increased solidly in March and early April. Nearly all retail stores reported sizable gains from earlier in the year. Most stores also reported very strong year-over-year sales growth, although some of these gains were due to soft sales during the onset of the Iraq war last spring. Among product categories, sales were particularly strong for women's apparel, electronics, and most luxury goods. Inventory levels were generally reported as satisfactory. Heading forward, most managers are very optimistic and plan to increase stocks to meet strong anticipated demand. Motor vehicle sales in the district also improved compared with previous months, although they were still

somewhat lower than a year ago in most areas. Most dealers anticipate further improvement in coming months, due in part to the spending of tax refunds. With the recent improvement in vehicle sales, dealers were generally satisfied with inventory levels, and many plan slight expansion of inventories in the months ahead. Travel and tourism activity in the district was mixed in March and early April. Airport traffic was up in most district cities, but activity at many Rocky Mountain ski areas slowed due to lack of adequate snowpack. Resort operators were optimistic about future tourism activity, as summer bookings have been strong. However, some tourist businesses that rely heavily on automobile travelers were worried about the potential impact of high gasoline prices this summer.

### **Manufacturing**

District manufacturing activity continued to expand in March and early April. Most manufacturers reported higher levels of capacity utilization than in the previous survey, and a larger number of firms said they were adding workers. Expenditures on plant and equipment also continued to rise solidly. Most plant managers reported continued increases in raw material prices, and many noted longer supplier delivery times. Higher material prices continued to put pressure on many firms' profit margins. However, more firms than in previous surveys were able to pass some of their recent cost increases through to finished goods prices. Expectations for future factory production and orders remained strong, and many plants plan continued moderate increases in employment and investment.

### **Real Estate and Construction**

Residential real estate activity strengthened further in March and early April, while commercial real estate markets generally remained weak. Single-family housing starts rose solidly in most district cities, and starts of luxury and second homes were reported to be especially strong in some areas. Nearly all builders anticipate continued strength in homebuilding heading forward, although limited availability and rising prices of some building materials were a concern. Realtors reported that home sales increased slightly in most district cities and were stronger than expected in several areas, including Denver. Home prices continued to increase at a moderate pace. Looking ahead, realtors expect home sales to continue to improve and home prices to rise slightly. Most mortgage lenders reported sizable increases in mortgage demand, due mainly to rising demand for home purchase loans. Lenders expect continued strength in mortgage demand through the summer. Commercial real estate activity in the district generally remained weak in March and early April, but a few signs of improvement were apparent. Prices for office space were flat to slightly lower throughout the district, and vacancy rates remained high by historical standards. In addition, several contacts reported nonresidential construction had been disrupted by rising prices and shortages of steel. On the positive side, vacancy rates in some cities edged down from earlier in the year, as absorption and sales of office space rose modestly.

### **Banking**

Bankers report that loans edged up and deposits held steady since the last survey, raising loan-deposit ratios slightly. Demand for commercial and industrial loans and commercial real estate loans increased, while demand for other loan categories was little changed. On the deposit side, slight increases in liquid accounts were offset by a decline in large CDs. All respondent banks left their prime lending rates unchanged, and most banks also held consumer lending rates steady. Lending standards were unchanged.

### **Energy**

District energy activity rose in March and early April from already high levels. The count of active oil and gas drilling rigs in the region was up slightly from the previous survey and up considerably from year-ago levels. Producers generally expect drilling activity to remain very strong in coming months, as energy prices are expected to stay elevated. Most

producers reported continued shortages of drilling equipment and qualified workers, and several contacts noted that some materials used for drilling, such as steel pipe and sand, were becoming very difficult to obtain.

## **Agriculture**

Agricultural conditions were little changed in March and early April from the previous survey. Prolonged drought in the western portion of the district continued to strain the winter wheat crop, and ranchers were concerned about pasture conditions. In contrast, eastern areas of the district received significant rainfall and had adequate subsoil moisture for spring planting. With soybean prices at 15-year highs, agricultural bankers expect more soybean planting this year than usual.

## **Wages and Prices**

Wage and retail price increases generally remained modest in March and early April, but an increasing number of manufacturers were raising their output prices. Labor markets showed further improvement, as hiring announcements by district firms continued to exceed layoff announcements. There were also more reports of labor shortages than in previous surveys. A number of contacts cited difficulties hiring nurses, skilled rig workers, geologists and engineers, and some types of factory and warehouse workers. Even so, most firms continued to have few problems hiring workers, and wage pressures generally remained muted. Several employers noted that high benefit costs continued to discourage them from hiring new employees. As a result, they were focusing on retraining current employees or hiring temporary workers. Most retailers reported flat selling prices compared with previous surveys and expect little change in prices heading forward. One store, however, reported increasing prices for furniture containing steel parts and for flooring items made from petroleum-based products. Builders reported that prices for lumber, sheetrock, and steel products rose again, and further increases are expected. Most manufacturers reported continued increases in raw materials prices. There were also more reports than in previous surveys of increases in finished goods prices, especially among producers of food, petroleum-intensive products, and steel-intensive products. Manufacturing materials prices are generally expected to continue rising in coming months. A growing number of firms expect to be able to pass along at least some of the future cost increases, in part by including price-escalation clauses in new customer contracts.

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## **Eleventh District--Dallas**

Eleventh District economic activity continued to accelerate from mid-February to mid-April. Retail sales growth was surprisingly strong, according to contacts, but there has been little change in demand for business services. Manufacturing respondents report that they are experiencing stronger sales that are partly the result of growing demand and partly the result of previous reductions in industry capacity. Construction and real estate activity is showing scattered signs of picking up. Residential activity remains quite strong but is softening. Contacts expressed concern that there will need to be a pickup in relocations or job growth for residential activity to remain strong and for nonresidential activity to strengthen. Agricultural conditions are favorable. In general, contacts are optimistic about the outlook for activity, but remain cautious, noting concerns that the upcoming presidential election will likely result in a lot of negative press about the economy that could dampen activity.

## **Prices**

Contacts report rising input costs in many industries, particularly manufacturing, with notably sharp increases for fuel, shipping, aluminum, natural gas, coke, coal, metals and food products. The lower value of the dollar was pushing up input costs for some



companies. Some cost increases are working their way through to selling prices. Contacts say they are absorbing a lot of the cost and are still finding ways to increase productivity to lower production costs. Even so, contacts say they will have to pass more along to the consumer very soon, and many expect to be able to do so.

Producers of cement, glass, tile and brick reported improved ability to pass cost increases forward to their customers. Lumber and paper producers also reported higher input and selling prices, and paper producers expect further gains in selling prices in the third quarter. Fabricated metals producers say heavy demand from China has drawn down their suppliers' inventories and led to shortages of several inputs, such as galvanized metal and steel. The removal of steel tariffs has not done much to alleviate price increases, they say, because supply lines that were directed away from the U.S. when the tariffs were in place have yet to be redirected back, leaving the industry dependent on domestic suppliers of steel.

Strong U.S. demand for gasoline lowered inventories and pushed up retail prices to record highs (in nominal dollars). Oil prices have been boosted by strong global demand (especially in Asia), threats of terror attacks, a lower dollar, low inventories, and the announcement of OPEC production cuts. Crude inventories have risen five of the last six weeks, and are now just above the lower range of five-year averages. Heating oil prices declined seasonally throughout the period from 94 to 84 cents per gallon.

Natural gas prices remain high despite inventories that are only slightly below normal for this time of year, pushed up by rising oil prices and expectations that future sources of natural gas will be more expensive. Petrochemical price increases are being seen in a long list of base chemicals and plastics, including ethylene, propylene, polypropylene, styrene, polystyrene, polyvinyl chloride, and PET bottle plastic. Capacity shortages are reported for ethylene, chlorine, styrene, but styrene pricing may fall back some as the turnaround season ends, and ethylene will soon face increased supply from a new facility that is just starting up.

Restaurant prices are up 1 to 2 percent. Legal fees are up 5 to 10 percent. Railroads continue to operate at or near capacity. Strengthening demand has enabled firms to raise prices and pass higher fuel costs on to customers. Trucking firms plan to increase prices to pass higher fuel costs on to clients.

Retailers say they are beginning to have some pricing authority. Input prices are higher for many products, largely because of the weaker dollar. Still contacts say they find ways to redesign products to lower the cost of production. Contacts also said that, in response to the antidumping concerns with Chinese products, they have been able to find furniture production in other countries at a similar quality and production cost. Retail inventories are in good shape, but retailers commented that they have remained conservative in their purchases for the rest of the year, preferring to be surprised by stronger demand that will allow pricing power rather than being left with excess inventory.

Some high-tech manufacturers reported significant price pressures, and bookings four months out suggest some moderate price increases. Telecommunication equipment prices remain low due mostly to an increasingly competitive market. Selling prices are also lower for apparel producers, and they see no signs of upward pressure in the future.

Airline passengers remain price sensitive and firms continue to offer discounts to stimulate demand. Industry capacity is outstripping GDP growth, and surging fuel prices are keeping profit margins slim. Carriers are having difficulty in pushing fuel surcharges through. Competition for new homes has put a lid on price increases despite higher steel and lumber costs.

**Labor Market**

Hiring is picking up for some types of workers, such as for production workers in high tech, apparel and lumber manufacturing. There is still a large pool of unskilled laborers seeking employment, according to contacts. Some companies in both services and manufacturing are continuing to outsource both domestically and internationally. Overall there continues to be very little pressure on wages, but most contacts reported continued health care pressures. Some respondents have suggested that this has been a main impediment to hiring full time workers. There has been a growing trend in some of these increases in health costs being passed along to the employee. One contact noted that, as a consequence, some workers had reduced or declined coverage and that there had been a sharp rise in workers' compensation claims and costs.

**Manufacturing**

Demand is up for apparel, food products, lumber and paper. Paper producers credit an increase in orders for packaging from retailers and the closing down of some competitors. Demand for some construction-related materials, such as cement, glass, tile and brick, was up markedly from January and up moderately from March 2003. One contact reported importing cement to meet demand within the District. Demand for primary metals is stronger than a year ago but has slowed some in recent weeks. Producers of fabricated metals say there has been little change in demand.

High-tech manufacturers report that growth in orders has increased slightly since the last survey. One contact said that growth is coming from increased demand for existing products and that, with the exception of high-definition TV and wireless communication, most manufacturers have not increased their research and development into new products. Telecommunications manufacturers have seen slow improvement in the last few months. Telecommunications service providers have seen a slight improvement in business spending, which is usually a promising signal of an improving market.

Demand for petrochemicals has been strong and the industry continues to improve, with only a few areas having a serious overcapacity problem, such as polystyrene. The overcapacity has been cured in some areas like chlorine and ethylene by a slump that lasted long enough to permanently close some plants. Competition from imports has been limited by a weak dollar and heavy demand from China. Strong demand for gasoline has boosted profit margins for refineries. Capacity utilization has been a little low, in part because of seasonal maintenance that is now ending. Inventories of gasoline are at a five-year low for this time of year.

**Services**

Legal contacts say activity continues at roughly the same pace. There has been a sporadic increase in merger and acquisition activity and a drop in work to support bankruptcies.

Transportation activity is mixed. Rail demand is strong across a range of categories and shipments are up significantly over last year. Contacts plan to hire additional employees and increase the size of their locomotive fleet. Demand for air travel is also up over the past month. Trucking activity is still soft, but contacts are optimistic that demand will improve.

**Retail Sales**

Most retailers reported surprisingly strong sales growth--even after adjusting for Easter sales occurring earlier this year than last year. In general, sales at higher end stores were better than of discount stores. Contacts say that consumers are happy and are showing "classic signs" that they have money to spend. Still many retailers are remaining cautious, planning their inventories for weaker sales than they hope materializes. Slow sales of automobiles continue to push down prices and cut into profit margins, according to dealers. Inventories at most dealers remain high.

## **Construction and Real Estate**

New home sales continue to rise at a good pace but are very competitive. Contacts say that demand is being driven by low mortgage interest rates rather than a pickup in employment growth or relocations. Some builders are reducing their inventory of homes because of less-than-predicted relocations. Existing home sales remain strong as well, but continued increases in home inventories have kept a damper on prices.

Apartment leasing picked up in Dallas and Houston over the past six weeks, according to respondents. Concessions are still rampant, particularly in Dallas, and effective rents continued to decline, but at a slower pace. Contacts are concerned about the amount of apartment construction and fear it may slow the sector's recovery.

Texas' largest office markets were mostly unchanged over the past six weeks. The amount of space available edged up slightly in Dallas, and rents fell, although the rate of decline has slowed compared with last year. Despite the large amount of space available, Dallas remains a hotbed of investor activity, according to respondents. Houston's weak downtown market is still dealing with repercussions related to the fallout in energy trading. Contacts say a recent announcement to relocate 2,000 employees into downtown is a promising sign.

## **Financial Services**

Lending continues to pick up, particularly for commercial and industrial projects. Consumer lending is also reported to be stronger than earlier this year or last year. Contacts say that activity is improving but not yet robust. Deposit growth is flat, which respondents attribute to money flowing back into financial markets. Continued competition, especially in the Dallas and Houston markets, remains fierce keeping rates down and fees/fee structures under pressure. Recent announcements by out of state banks to enter these markets and aggressive expansion by banks already in these markets are putting downward pressure on rates and fees.

## **Energy**

Onshore drilling continues to respond to higher energy prices. Drilling activity is mostly simple, low risk, low cost rigs that add little to the demand for services, however. Although some respondents made hopeful statements that some areas of the oil service business might tighten soon, there remains considerable excess capacity in all lines of business. Offshore drilling in the U.S. continues to decline, and there is no indication it will pick up soon. Oil producers continue to claim there are no good prospects left in the region. International drilling remains strong. Only the largest companies are active in this part of the industry.

## **Agriculture**

Farmers continue to prepare land for planting. Contacts report that the outbreak of the avian influenza reported in early 2004 in Gonzalez County has been officially declared eradicated, benefiting poultry producers in the District. Demand for beef strengthened and prices edged up. Mexico opened its markets to beef from the U.S., and contacts report shipping beef in large numbers. No new cases of BSE have been found.

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## **Twelfth District--San Francisco**

Reports from business contacts indicate that the Twelfth District's already firm economic expansion acquired some additional momentum in March and early April. Price inflation for final goods and services has remained low overall, although increases in the prices of energy and key industrial commodities raised costs in some industries. Some District firms have increased their hiring pace for permanent employees or indicated plans to do so in the near future. District retailers and service providers saw generally solid demand. Manufacturing

activity picked up for a variety of products. Both domestic and foreign demand for District agricultural and resource-related products reportedly was solid. Activity in residential real estate markets remained vibrant, while the glut in commercial real estate markets eased a bit. Most banks reported solid loan demand.

### **Prices and Wages**

The reports indicated a slight pickup in the pace of price increases in recent weeks. Contacts noted rising prices for gasoline and certain commodities, notably steel. These increases raised transportation costs for consumers and businesses and also raised production costs in selected industries, but the overall impact on final prices was limited, reportedly due to stiff competition in most industries.

Upward wage and salary pressures in the District were quite modest during the survey period. However, the rising cost of health benefits increased labor costs somewhat, and employers have responded in part by shifting some of the burden to workers. In labor markets more generally, respondents noted a modest pickup in hiring by District businesses, especially in the construction, education, health-care, and retail sectors. Hiring was focused largely on permanent rather than temporary workers, and some firms not currently hiring reportedly plan to do so in the near future. By contrast, some state and local governments cut staff due to budget constraints.

### **Retail Trade and Services**

District retail sales were solid overall and generally stable relative to the previous survey period. Automobile sales were at high levels, sustained in part by renewed financing incentives. However, sales were stronger for foreign than for domestic makes, and inventories were at unusually high levels.

District service providers saw further strengthening in demand. Sales increased for media services and high-tech services in some areas, and reports indicated that activity at District seaports had stepped up to handle increased merchandise trade flows. Demand for preventive and outpatient health-care services edged up further, although rising out-of-pocket payments for patients reportedly have led to reduced use of hospital services in some areas. District travel and tourist activity generally was solid, with notable strength reported for Hawaii, Utah, Arizona, and Southern California. A Southern California respondent also noted substantial sales gains in the restaurant industry there. The weak dollar relative to the yen reportedly helped boost Japanese visitor counts to selected District destinations. Although hotel occupancy rates rose in many areas, room prices generally remained somewhat low compared to prior years, reportedly due in part to rising reliance on bargain deals available through the Internet.

### **Manufacturing**

District manufacturers generally faced increased demand for a variety of products, consistent with reports of a further pickup in capital spending by firms during the survey period. Sales of semiconductors and other high-technology products strengthened, as businesses replaced existing stocks of computer and communications equipment. Prices for high-tech products rose modestly, due to reduced inventories and increased capacity utilization. Both domestic and foreign demand for wood products was strong, and prices for pulp, containerboards, and wood panels edged up as a result. District apparel makers saw rising orders, and relatively lean inventories kept prices elevated in recent weeks. The weak dollar has helped boost exports of many manufactured products; however, it also has increased prices on imported raw materials and intermediate goods, exacerbating increased production costs associated with rising scarcity of selected commodities, particularly steel.

### **Agriculture and Resource-related Industries**

District contacts reported robust demand and sales for a variety of agricultural and resource-

related items. Demand for nuts was especially strong, and several countries have relaxed bans on imports of American cattle, increasing the demand seen by District cattle ranchers. More generally, agricultural contacts reported that demand for items with high protein content has been boosted by the growing popularity of protein-heavy diet regimes. Overseas demand for District agricultural products remained quite strong, held up in part by the low value of the dollar. In energy markets, capacity utilization was high for electrical generation and oil and natural gas extraction, and contacts noted scattered capacity increases.

### **Real Estate and Construction**

Residential real estate markets remained robust during the most recent survey period, and conditions improved a bit in nonresidential markets. The pace of home sales, price appreciation, and construction was rapid, especially in Southern California and Hawaii, and new homes sold quickly, often before completion. However, higher-priced homes typically remained on the market longer than less-expensive homes. With low interest rates pushing up home ownership rates, apartment vacancies edged up further in some areas. On the commercial side, demand for office space improved a bit, with a slight dip in vacancy rates reported for some markets. Moreover, demand for industrial and retail space was solid in parts of Southern California, and contacts noted several large-scale construction projects in that region.

### **Financial Institutions**

District banking contacts reported that overall demand for commercial and industrial loans improved slightly, particularly for loans to small businesses. Demand for commercial real estate loans picked up in several markets, and bank loan portfolios generally exhibited stable credit quality.

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