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Summary of Commentary on ______________________

Current Economic Conditions

by Federal Reserve District

July 2002

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SUMMARY*

District reports suggest that the economy expanded modestly in recent weeks, with an uneven performance across sectors. Boston, New York, Atlanta, and Dallas noted some tapering off in economic growth, while Cleveland and St. Louis indicated some improvement. Reports from the rest of the Districts point to continued moderate growth. Overall, prices of finished goods and services remained stable, though there were scattered reports of price pressures.

Retail sales were mixed, with four Districts indicating some weakening, but five reporting a pickup, partly weather-related. Retail inventories were said to be in good shape, and many retailers expressed optimism about the near-term sales outlook. Vehicle sales were seen as weak in June but were boosted by incentive programs in early July. Manufacturing activity, though mixed across Districts and industries, appears to have improved, on balance.

Residential real estate and construction activity was widely described as strong, though some softness was reported in the rental segment. In contrast, commercial real estate was almost universally described as weak, though stable in some cases. Travel and tourism activity was reported to be little changed overall, with the Western Districts tending to fare somewhat better than those on the East Coast. Reports from other service industries mostly pointed to stable activity. Banks reported strong demand for residential mortgages, steady demand for consumer loans, and weak, but in some cases improving, demand for commercial loans. Credit quality was still described as good, with no significant increases reported in delinquency rates. Agricultural conditions were described as poor in a number of Districts.

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* Prepared at the Federal Reserve Bank of New York and based on information collected before July 23, 2002. This document summarizes comments received from businesses and other contacts outside the Federal Reserve and is not a commentary on the views of Federal Reserve officials.

Labor markets were characterized as slack but relatively stable in most Districts; New York and Kansas City indicated some softening, but Richmond noted modest improvement. The pace of wage increases generally remained subdued, but many Districts noted continued escalation of non-wage benefit costs, most notably health insurance. Prices of raw materials were generally stable, though prices of steel, plastics, and lumber have risen noticeably. Prices of finished goods and services were generally flat.

Consumer Spending

Retail sales were mixed across the Districts, with auto sales getting some boost from incentive programs in July. Some pickup in non-auto sales was reported in the New York, Cleveland, Richmond, St. Louis and San Francisco Districts, with some of the strength attributed to weather. However, Boston, Atlanta, Chicago, and Dallas indicated some weakening in spending. In general, purchases for the home—building materials, hardware, and furnishings—were characterized as strong. None of the Districts reported any complaints about retail inventory levels, although New York and San Francisco mentioned some intended inventory accumulation in anticipation of a longshoremen's strike on the West Coast.

Looking ahead, there tended to be a general sense of optimism about the near-term outlook, though contacts in a number of Districts expressed concern about the risk that declining equity markets would affect the real economy. Retailers were said to be optimistic about the sales outlook in Philadelphia, Cleveland, Richmond, and Kansas City. However, contacts in the Boston and Dallas Districts expressed some concern. New York reported a decline in consumer confidence in June.

Reports from automobile dealers were mixed, with June sales described as somewhat disappointing but July sales boosted by incentive programs. Cleveland noted a decline in new car sales, but steady demand for used vehicles. Looking ahead, auto dealers expressed some concern about inventory levels and future sales prospects in the Cleveland and Kansas City Districts.

Manufacturing

Manufacturing activity was generally reported to have improved modestly. While none of the Districts reported a general decline, many noted that some industries were expanding moderately while others were continuing to struggle. Vehicle assemblies and parts production were reported as expanding by Cleveland, Chicago, St. Louis, Boston, and Atlanta, although Philadelphia reported some slippage in transportation equipment orders. The semiconductor industry has continued to improve according to Dallas, San Francisco, and Boston.

Production of construction-related materials, primarily residential, was still displaying strength in the Chicago District, generally up according to Dallas, brisk as reported by Philadelphia, and relatively strong in the Atlanta District. New York reported a general increase in overall manufacturing activity through June, but a modest weakening of conditions in early July. Minneapolis reported activity as increasing in Minnesota and the Dakotas. Richmond reported mixed conditions, with a rise in tobacco and paper manufacturing, but slippage in furniture and textiles. Kansas City saw continuing signs of a manufacturing recovery, despite some weakening in the volume of new orders, and firms were not quite as upbeat as a few months ago. Inventories were generally reported as steady or continuing to decline, and nearly all Districts reported continued optimism about the near term.

Real Estate and Construction

Residential real estate continued to show strength in virtually all Districts, but the commercial real estate sector continued to struggle. An overwhelming majority of Districts described the housing market as robust, with sturdy gains in sales activity and varying degrees of price appreciation. The weakest report on this sector came from Dallas where housing markets were said to be unchanged. Despite the overall strength, some weakness was noted at the upper end of the market in Richmond, Chicago, St. Louis, Kansas City, Dallas, and San Francisco. Declining equity markets were cited as one cause of this relative weakness, though New York noted that there has been no discernible effect thus far. In contrast, a number of Districts indicated that declining stock prices have actually boosted the perceived attractiveness of real estate as an investment. Apartment rental markets were reported to have softened in Richmond, Minneapolis, and San Francisco, but to have stabilized in New York.

Residential construction activity was mixed but generally strong. Strong or increasing activity was reported in Atlanta, St. Louis, Minneapolis, Kansas City, and San Francisco. Shortages of developable land were said to be inhibiting construction activity and driving up prices in the Boston and Chicago Districts.

Commercial real estate markets remained weak in most areas, with increasingly slack conditions noted in New York, Richmond, Atlanta, Chicago, Minneapolis, Kansas City, Dallas, and San Francisco. However, Cleveland noted an up-tick in conditions, though from low levels. Despite widespread weakness in office markets, Richmond noted some scattered signs of strength in the market for retail and warehouse space. Commercial construction activity continued to be sluggish in most areas.

Tourism and Services

Tourism and travel activity was relatively stable, on balance. Signs of improvement were noted across much of the western United States—specifically in the Minneapolis, Kansas City, and San Francisco Districts. However, there were reports of modest weakening in Districts along the Atlantic Coast. New York noted some slippage in hotel room rates; Richmond reported strong tourism activity and increased air travel in July but weaker hotel bookings for the months ahead; and Atlanta indicated declining hotel occupancy rates, as well as shorter stays and less spending by visitors to Florida.

Conditions in other segments of the service sector were mixed. Boston reported that insurers have seen strong demand for life insurance but some declines in health plan membership due to softening labor markets. Richmond reports strong growth in trucking and shipping activity. Dallas notes slow improvement in service sector activity.

Banking and Finance

Banks report little change in overall lending activity, with continued strong demand for home mortgages and continued weak demand for business loans. Some softening in consumer loan demand was reported in New York and Dallas, but a moderate increase was noted in Atlanta. Home mortgage lending was reported to be strong in most Districts, with further strengthening seen in Philadelphia, Richmond, Chicago, and Kansas City. Also, refinancing activity increased in the Chicago and Kansas City Districts but weakened in New York and Cleveland. Delinquency rates were mostly stable and overall credit quality was described as strong and stable in most areas—including St. Louis, which reported an increase in bankruptcy and past-due filings. Tighter lending standards were reported in New York and Kansas City. More broadly, San Francisco reports that the financial sector remains healthy, but Philadelphia reports that investment firm revenues have been adversely affected by consumers shifting funds from equities to money markets.

Agriculture, Mining, Natural Resources

Agriculture conditions were mostly reported as poor, although conditions improved in parts of the South and West. Much-needed rains improved conditions in the Dallas District, parts of the Minneapolis District, and in Florida. However, drought or near drought conditions persisted in the Chicago, Richmond, Cleveland, and Kansas City Districts, and some states in the St. Louis, Minneapolis and Atlanta Districts. Most soybean and corn-producing areas suffered from oppressive dry conditions. A particularly severe drought continued to pummel Virginia and the Carolinas. Areas with dry weather also reported deteriorated pasture conditions for livestock grazing.

Energy activity was described as strong by Kansas City and Dallas, though oil and gas drillings leveled off in both Districts in late June and early July after a strong May. Dallas reported smaller energy firms pulling back in recent weeks, cautious about anticipated lower demand for oil and natural gas. Kansas City reported some downward pressure on earnings in the natural gas industry, with prices flat nationwide but falling sharply in Wyoming.

Labor Markets, Wages, Prices

Labor markets were generally reported as subdued, with little or no upward pressure on wages. There were spotty reports of increased hiring in particular occupations, such as engineers, skilled nurses, skilled construction workers, and mortgage processors. While most Districts indicated little change in labor markets, New York and Kansas City reported some softening since the last Beige Book, and most contacts in the Cleveland and Minneapolis Districts indicated that they had no plans to increase hiring.

Temporary employment activity was mixed but a bit stronger on balance—while New York and Chicago reported weakness, Richmond, Dallas, Atlanta, and Cleveland indicated some increase in activity. In the manufacturing sector, Richmond and Chicago reported some recent weakening in employment; however, Kansas City noted some improvement, and contacts in New York and Richmond indicated some pickup in labor demand in light manufacturing. Richmond and St. Louis commented that manufacturers plan to increase employment in the months ahead. Separately, Richmond reported increased hiring at service and retail firms, but Boston indicated a decline in retail administrative and sales workers. Job declines continued in the airline industry in the Dallas District.

Wages were reported to be steady. Dallas noted some decline in wages of temp workers, while Kansas City indicated scattered labor shortages, but otherwise there was virtually no mention of wage pressures. However, there were widespread reports of escalating non-wage benefit costs.

Prices for most goods and services were steady, with the widely noted exceptions of insurance (particularly health insurance), building materials (particularly lumber), steel, plastics and paper. Prices of other inputs, as well as selling prices, remained flat or declined, especially in manufacturing, according to nearly all Districts. There was continued discounting of retail products to entice consumers, according to some Districts. Spikes in wholesale spot electricity prices were reported in the San Francisco District due to warm weather. Boston reported a firming of semiconductor prices but declining prices for other high-tech goods. Dallas noted a continued downward drift of natural gas prices due to a build-up of inventories, which are likely to reach record levels by late summer. Chicago reported a firming of land prices for residential construction, while Richmond reported a moderate rise in service sector and manufactured goods prices.

FIRST DISTRICT – BOSTON

The First District economy is said to be going through a "bumpy" period. Manufacturing reports continue mixed, with makers of defense, medical, and automotive equipment and semiconductors doing better than producers of IT and telecom equipment or nonmilitary aircraft. Retailers are less upbeat than they were in April and May, with sales mostly flat or down from year-earlier levels. Results for insurance firms vary by sector, while residential real estate markets remain strong. Many contacts express caution and uncertainty regarding the outlook.

Retail

Most contacted New England retailers report that sales were flat or down in May, June, and the beginning of July, compared with prior-year sales. Several companies cite deterioration after positive results in the first part of the year. The most upbeat reports came from a lumber/hardware store that is seeing strong demand for remodeling and kitchen and bath installations as well as new construction, and from a furniture retailer that had positive sales growth until July, when sunny weekend weather set in. An office-supply store reports that consumables like paper and inkjets are selling well, but that sales of bigger-ticket items are slowing. Other retailers are disappointed with below-expectation sales so far this summer; this group includes a computer wholesaler whose sales are down 15 percent from last year.

Most retailers are holding employment steady, though several report layoffs and attrition, especially of administrative and sales employees. Most are granting modest wage increases, with one employer ending a wage freeze in April. Vendor prices are generally stable; exceptions include high-tech goods continuing a trend of price declines and lumber prices, which have firmed up recently after exhibiting multi-year lows. Most retailers claim profit margins are stable.

Overall, the contacted retailers have subdued expectations for the remainder of the year compared with their relative optimism a few months ago. Most express hope for modest growth in their own firm's sales, despite low expectations for the economy overall. By exception, lumber/hardware sellers look forward to continued good business. Catching the mood of other respondents, one retailer characterizes the outlook as "imponderable."

Manufacturing and Related Services

First District manufacturing contacts report mixed trends for revenues and orders in the second quarter and early third quarter. Demand for defense equipment and medical-related equipment and supplies is on an upward trend, and sales of automotive parts remain healthy. Semiconductor firms indicate that business remains below year-ago levels but has turned up nicely in response to rising capacity utilization at fabrication facilities in the Far East. Similarly, manufacturers of industrial equipment and paper report recent upturns in demand, albeit not sufficient to offset declines during the past year. Contrasting these positive developments, other contacts report that the slump is continuing or that the pace of growth has slowed. Sales of information technology equipment, nonmilitary aircraft, telecommunications equipment, and advertising materials remain depressed. Sales of technical publications have weakened as customers in industries such as financial and legal services, consulting, and IT scale back.

Selling prices and materials costs are mostly flat to down. Prices for plastics, paper, and semiconductors have reportedly firmed in recent months. Companies report that increased sourcing outside the United States is resulting in lower purchasing costs.

Employment trends are mixed. Companies that are increasing head counts are doing so cautiously, and some other companies are still cutting jobs. About one-half of the contacted manufacturers have at least selective pay freezes in effect, especially for salaried employees, but some of these firms now plan to raise pay this year. Reported pay increases are typically around 3 percent.

Responding companies generally report that capital spending remains modest. Some firms are increasing their equipment purchases in order to improve the quality of their products or processes, or to develop new products in response to changes in technology.

Although quite a few contacts believe that the worst is behind them, the prevailing mood is somewhat subdued. Respondents say that the recent stock market decline and concerns about corporate accounting irregularities may depress demand for their products. Some also worry that no upturn is in sight for industries such as IT, aerospace, and telecommunications.

Residential Real Estate

Residential real estate markets in New England remain very strong. Demand is high, stimulated both by low interest rates and by uncertain financial markets—many buyers are said to have turned to housing as an alternative to equity. Contacts complain about lack of inventory throughout the region.

Respondents report that most newly listed property sells within a few days, in most cases at the asking price, and sometimes with multiple bids. The only exception is Vermont, where the number of listings in the mid-price range is said to have risen during the past quarter.

Home prices continued to rise through the second quarter. Contacts say the increases are especially pronounced in Massachusetts; the other New England states report moderate price increases. New construction is down in most states because of a lack of available land, with the exception of Maine, where new construction is very active. Most contacts expect continued strength in housing markets in the short term, with price appreciation slowing down in the second half of the year.

Insurance

Life insurance contacts continue to report very strong demand. Sales are said to be up 25 to 35 percent in the second quarter from a year earlier. Reports from disability and health insurance providers are less upbeat. The level of disability claims continues to be higher than normal, which one respondent believes is a reflection of soft labor markets. Contacts are having some success raising their rates without losing much business and are thereby offsetting part of the financial losses from higher claims. By contrast, one respondent in health insurance mentions ongoing declines in membership. These declines are partially due to rate increases this company put in place earlier this year to cover rising medical costs and partially due to layoffs by client companies. Insurance companies' mutual funds show mixed results; some are having "surprising" success while others are in net redemption.

Insurance industry respondents are less optimistic than they were earlier in the year, especially when looking at their investments and mutual fund sales. Employment in the sector has mainly been flat, as many contacts report continued efforts to improve efficiency. Most say that they do not expect significant changes in the second half of the year. However, those with current sales running higher than anticipated foresee some softening of demand and a return to expected levels.

SECOND DISTRICT--NEW YORK

Economic growth in the Second District appears to have eased off since the last report, with signs of renewed weakness in commercial real estate, and employment, but resilience in housing. There continue to be no signs of price pressures. The labor market has shown signs of softening since the last report. Retail sales have picked up since the last report, though most of the improvement was attributed to the belated arrival of hot weather; retail inventories are described as lean, despite some intentional inventory accumulation in anticipation of a possible longshoreman's strike.

Manufacturers, after indicating improvement through most of the second quarter, report some slowing in activity in late June and early July, though business contacts remain fairly optimistic about the near-term outlook. Housing markets have shown resilience, characterized by strong construction and resale activity, further increases in selling prices and stabilization in the rental market. In contrast, commercial real estate markets in and around New York City have shown renewed signs of weakening. Finally, bankers report a continuation of most of the same trends seen in the last report: weakening demand for consumer loans, rising demand for commercial loans, and tighter lending standards; however, delinquency rates, which had been declining, leveled off in July.

Consumer Spending

Major retailers report that sales, which had been below plan in May, improved somewhat in June and early July and were back on or close to plan. However, much of the recent strength—as the earlier weakness—was attributed to the belated arrival of hot summer weather, which boosted sales of air conditioners, summer apparel, and lawn and garden merchandise. More generally, electronics, home furnishings, and women's apparel were described as the strongest categories, while men's and children's apparel were said to be weak. Retailers report that inventories remain at very favorable levels—roughly 5-10 percent lower than a year ago, on average—even though some contacts have accumulated extra inventories in anticipation of a longshoreman's strike. Selling prices, merchandise costs, and retail wages remain steady, though non-wage costs continue to escalate.

Consumer confidence edged lower again in June, according to the latest survey of New York State residents, conducted by Siena College. While there was little change in the public's assessment of current conditions, residents of both upstate and metropolitan New York City expressed increased concern about future conditions.

Construction and Real Estate

Housing markets continue to show resilience across most of the District. Homebuilders in northern New Jersey say the underlying tone of the housing market remains strong, though prices appear to be leveling off. The only sign of slack market conditions was along the "Gold Coast" (across the river from New York City), where a substantial number of new multi-family units have come on line in the past year. However, builders indicate that demand for single-family homes continues to outstrip supply.

Contacts in Manhattan's real estate and appraisal industries report that market conditions remain fundamentally strong, despite weakness in the financial markets. The number of co-op and condo transactions in the second quarter was reported to be up nearly 50 percent from a year earlier and one of the highest on record. Moreover, the average selling price, adjusted for changes in the mix of units, was up roughly 3 percent from the prior quarter and also up 3 percent from a year earlier. One contact notes that, while it is too early to gauge the effect of the recent decline in the equity markets, as of the third week in July, there have been no reports of any buyers pulling out of deals. New York City's apartment rental market has also shown signs of stabilizing—a major rental real estate firms reports that rents have stopped falling but are still down 5-7 percent from mid-year 2001 levels. Most of the improvement in the rental market is reported to be at the upper end.

Commercial real estate markets, which had shown signs of stabilizing in the last report, appear to be slackening once again. In Manhattan, Midtown's vacancy rate climbed to 8.5 percent at mid-year, from 7.8 percent at the end of the first quarter. At the same time, Downtown Manhattan's rate soared from 11.9 to 14.5 percent, a five-year high. Office rental markets in New York City's suburbs also slackened, to varying degrees, in the second quarter. Long Island's vacancy rate rose 2 points to 13.3

percent, while Fairfield County, Connecticut's rate climbed to an eight-year high of 18.3 percent. Vacancy rates rose only modestly in Westchester County and northern/central New Jersey, ending the second quarter at 17.1 and 15.8 percent, respectively. Asking rents are down 10 percent from a year ago in both Manhattan and Fairfield County, but are little changed in New York City's other suburbs.

Other Business Activity

A major New York City employment agency reports that local labor demand, which had been showing signs of improving for much of this year, has tapered off in June and early July. Hiring activity is described as disappointing—particularly in the financial, business and legal services industries—but not as weak as in late-2001, and not nearly as bad as in the early-1990s recession. Separately, temporary help agencies in upstate New York State report sharp declines in demand for contract and temp workers compared with a year ago—particularly in the information technology area. However, in recent weeks, two agencies note a pickup in demand for mortgage processors and light manufacturing workers.

Recent surveys of purchasing managers and manufacturers paint a mixed picture of current conditions but indicate continued optimism about the near-term outlook. Buffalo-area purchasers report some improvement in business conditions in June, with increases reported in both production activity and new orders. Similarly, Rochester-area purchasers report a noticeable pickup in business activity in June, following weak conditions for most of this year. New York City area purchasing managers remain optimistic about the business outlook but report that current conditions were mixed in June—those in the manufacturing sector indicate widespread improvement, but other types of firms, particularly not-for-profits, report increased weakness. More recently, though, New York State manufacturers report weakening in business conditions in our latest monthly survey, conducted in early July, though respondents continue to express widespread optimism about the near-term outlook. Manufacturers and purchasing managers report little change in merchandise costs and steady to lower selling prices.

Finally, Manhattan hotels report that occupancy rates were little changed in June and continued to run slightly below year-earlier levels. However, average room rates weakened somewhat and were down 13 percent from a year earlier.

Financial Developments

Small to medium-sized Second District banks report mixed demand for loans since the last report, with increasingly widespread weakness in demand for consumer loans, but continued strength in demand for commercial and industrial loans. Refinancing activity continued to decrease, on balance. On the supply side, bankers again indicate tightening credit standards for all types of loans except for residential mortgages, where standards remain stable. Interest rates on both loans and deposits decreased across all categories; most notably, four out of five bankers report lower rates on home mortgages. Lenders report stable delinquency rates for all types of loans.

THIRD DISTRICT – PHILADELPHIA

Business activity in the Third District edged up in July. Manufacturers reported increases in shipments and orders, but the improvement was not as extensive as it had been in the past few months. Retail sales of general merchandise were virtually steady in July and up slightly from the same month last year. Auto sales picked up a bit as manufacturers renewed incentives. Bank loan volumes moved up marginally, mainly because of some growth in consumer and real estate lending. Commercial and industrial loan volume has been flat. Investment companies in the region reported an increase in transfers from stock funds to money-market funds by individual investors in mid-July.

The outlook among Third District businesses contacted in July is for further, although modest, improvement. Manufacturers forecast increases in shipments and orders during the next six months, and they are planning increases in capital spending. Retailers expect steady sales for the rest of the summer. They are generally optimistic about the back-to-school shopping period, but express some concern about the effect of financial market conditions on consumer confidence. Most of the auto dealers surveyed for this report anticipate steady sales for the rest of the year, although some expect a slowdown. Bankers expect slow growth in overall lending, with further gains in consumer lending and some strengthening in loan demand from businesses.

MANUFACTURING

Manufacturing activity in the Third District continued to move up in July although gains were not as widespread among the region's manufacturers as they were in the spring months. Business varied across the major goods-producing sectors in the District. Conditions were relatively stronger among companies that make building materials and fabricated structural components, as construction activity remains fairly brisk. Demand has also been rising for textiles and paper products, such as stationery and packaging. In contrast, producers of basic metals, transportation equipment, and industrial equipment indicated that orders have slipped recently. For the manufacturing sector as a whole, new orders and shipments were just edging up in July.

Area manufacturers continued to reduce inventories in July, on balance, although half of those contacted for this report said they were maintaining steady inventories. A large majority of manufacturers indicated that prices for both inputs and the goods they manufacture were steady in July, but reports of higher prices for steel were widespread. Rising health care costs continue to be a concern for manufacturers as well as other employers in the region.

The region's manufacturers forecast better business conditions during the rest of the year despite the recent easing in the rate of improvement. Over half of the firms surveyed in July expect increases in orders and shipments during the next six months, while few anticipate decreases. The region's manufacturers have raised capital spending plans, on the whole. In particular, higher outlays for new plant and equipment are scheduled for the second half among producers of basic metals, electrical equipment, and industrial materials and machinery.

RETAIL

Third District retailers generally reported a steady rate of sales during July. Compared with a year ago, sales were up slightly in most product categories. Some store executives noted recent increases in the average amount of spending per customer. Discount stores have posted relatively better results than other types of stores, in general, although sales have varied among the non-discount stores. Some apparel retailers have done quite well on a year-over year basis while others have been struggling, and department stores' recent sales have been mixed. Most retailers indicated that they have been cautious in purchasing goods for the summer months, and they have kept inventories in line with the recent sales rate.

Auto dealers said sales in July picked up slightly with new manufacturers' incentives, although the annual rate of sales remains below last year's pace. In general dealers said their inventories were at appropriate levels.

Retailers expect sales to remain steady through the rest of the summer and pick up for the back-to-school season. Store executives expressed guarded optimism for the fall. They believe the course of retail sales will depend largely on overall economic conditions, but some are concerned that financial market turmoil could lead to a pullback in consumers' willingness to spend. Most auto dealers expect sales for the rest of the year to be steady at about the current rate, but some anticipate a slowdown toward the end of the year, and they note that manufacturers appear to be trimming production plans.

FINANCE

Outstanding loan volume at Third District banks was moving up slowly in July. Residential real estate lending continued to move up. Consumer credit also increased, mainly through credit cards. Commercial and industrial loan volume has been flat in recent weeks. Some bank lending officers noted that requests for credit from businesses have slowed significantly since the spring. Several bankers mentioned that competition remains strong among banks and between banks and nondepository lenders, keeping lending rates in check. Some bankers also indicated that competition for deposits has become stiffer recently, putting some upward pressure on deposit interest rates.

Bankers in the Third District expect overall lending to continue to grow slowly this year. They anticipate a modest pickup in business lending and continuing growth in consumer lending. However, some bankers expressed concern that consumers are building up unsustainable debt burdens, and they expect an easing in personal loan growth and some deterioration in personal credit quality later this year. Several bankers also indicated that they expect the level of residential lending to ebb.

Investment companies contacted in mid-July reported that they were experiencing high levels of activity from individual investors switching out of domestic equities. A few firms indicated that a small number of investors were closing accounts entirely, but the overwhelming majority of customers were moving into money-markets funds. There also appeared to be a minor movement into foreign stock funds and small-cap value funds. Investment companies expect some diminution in their revenues as more funds go into money-market funds with lower fees than stock funds.

FOURTH DISTRICT – CLEVELAND

Economic conditions in the Fourth District during June and the first half of July showed some improvement from the last report. Shipping activity continued to increase, reports of expansion in manufacturing have spread, and improving sales figures were reported across the retail sector (as opposed to only among discount retailers, as had been the case since the start of the year). Since the last report, however, banking conditions remained mixed, and commercial construction continued to struggle. Most contacts believe that business activity during the second half of 2002 will be stronger than the first, although many qualified their outlook with the caveat that the stock market decline and news of accounting scandals could scare consumers into holding onto their money.

Many contacts reported having increased or planning to increase their capital expenditures. Some manufacturers reported having completed capital expansion projects that were started before the recession. Retailers reported expanding their chains as planned, with no or few delays. Commercial builders reported that many projects that had been on hold were finally begun during the survey period. In the trucking and shipping industry, if companies could, they were purchasing new trucks before prices rise as a result of tighter EPA standards that will take effect in October.

Labor markets showed little change since the last report. The supply of labor remains plentiful, and those few contacts looking to hire reported that skilled labor was not difficult to find. Demand for temporary labor was up slightly, but contacts reported that this was typical for this time of year. Very few contacts plan to hire new workers or recall temporarily laid-off workers, although contacts seemed to think this would likely change in the next couple of months. Health care benefits remain a point of contention between unionized labor and employers, as do pension plan benefits — unions are pushing for defined-benefit plans, as opposed to defined-contribution plans.

Contacts noted mixed price trends. As has been the case for a while, most contacts reported that the costs of health care and insurance were on the rise. Manufacturing contacts, however, reported that the cost of most of their inputs have been falling, as have the prices of their finished goods. Construction and retail contacts reported little change in prices. Steel prices have stabilized over the last month.

Manufacturing

The manufacturing sector saw expansion across the District in June. Several nondurable goods manufacturers saw expanded capacity come on-line recently (some of these projects were planned as early as 1999). Contacts reported that inventories are steady and now at acceptable levels — they had been higher than preferred during the first quarter. Overall, contacts reported that new orders rose through June and the first half of July, suggesting continued expansion. Manufacturers are optimistic that the recovery in the industry will persist.

Automakers in the District again reported significant amounts of overtime in June. Most plants in the District were closed the first two weeks of July to retool their plants for 2003 models, although some closed the third week of July. At the time of the survey, some plants already had scheduled overtime for the fourth week of July.

Steelmakers reported that business conditions remained steady through June and the first two weeks of July. Contacts in rolled steel reported that most of their mills were operating at or near full capacity and they are expected to be at full capacity through the third quarter because order books for August and September are filled. Demand for stainless steel is weak, considerably lower than at the start of the year. Prices for steel have held steady, as most of the spot price increases have already been implemented and most contract prices are not negotiated until the fourth quarter.

Retail Sales

Retailers appeared more optimistic in this report, with most noting improved sales since the last report. Discount retailers noted continued steady growth, while specialty retailers reported improvement in conditions relative to the first five months of 2002. Apparel retailers saw improved sales with the summer season, with one contact reporting record sales in one of its clothing lines. While a few contacts continued to report year-over-year losses, they noted that their losses were smaller in June. Contacts reported that inventories remained low because they were still managing inventories conservatively. For the most part, area retailers expect sales to increase at an annual rate of 1 to 3-1/2 percent during the second half of 2002.

In contrast to most retailers, automobile dealers reported that new car sales steadily declined through June and the first two weeks of July. Used-car sales, however, have remained relatively steady. Dealers are pessimistic about business through the rest of the year, with most expecting year-over-year declines.

Construction

District homebuilders continued to report that they remain guardedly optimistic amid fairly stable business conditions. Commercial builders, on the other hand, continued to report an unfavorable economic climate through the survey period. Some commercial building firms report that year-to-date revenues are half what they were a year ago. Although commercial builders reported that the rate of customer inquiries began to increase in July, the increase was modest. Commercial builders, by and large, however, hope that the uptick signals the beginning of a better economic environment.

Trucking and Shipping

Contacts reported that trucking and shipping activity in the District saw strong monthly growth during June. Year-to-date, the industry is showing an increase in activity, despite a slowdown due to the Fourth of July holiday falling in the middle of the week. Shipments of steel and nondurable manufacturing goods have seen the largest year-over-year increases, but growth has been strong across all industries. Contacts remain optimistic that industry's recovery will continue.

Banking

Half our contacts reported no change in their net interest margin, while the other half noted tightening in the margin. Competition for borrowers remained aggressive as demand for commercial loans remained weak. On the consumer side, roughly half of our contacts reported that demand for loans was lower than last year, while half reported demand was higher. Demand for refinancing has slowed considerably since the start of the year. Both the rate of loan delinquencies and the credit quality of applicants have remained unchanged from the start of 2002.

Agriculture

Crop farmers (primarily corn and soybeans) reported being off to their worst start in 10 years. Heavy rain during the spring delayed planting — while May 10 is the target date by which farmers try to have all their crops planted, farmers were planting as late as the last week of June. Because crops were planted late, farmers were already expecting a poor year. Dry conditions through June and July have further depressed their yield estimates. Most farmers expect year-over-year losses.

While livestock producers are experiencing a good production year, they reported that current market prices were below the cost of production. Except for cases where price contracts were negotiated, livestock farmers expect to experience year-over-year losses for the first time in many years.

FIFTH DISTRICT–RICHMOND

Overview: Economic activity in the Fifth District continued to expand at a modest pace in June and July. Manufacturing activity grew at a somewhat slower pace in the last six weeks, while services firms' revenues were generally flat. In retail, sales edged higher although shopper traffic remained light. Home sales were strong in most areas, as mortgage interest rates remained attractive to homebuyers. The volume of mortgage lending grew modestly and the demand for commercial loans picked up. Evidence of price inflation remained scant. On District farms, a severe drought continued to stress crops and, in some areas, farmers were culling cattle as pasture conditions deteriorated.

Retail: Most District retailers reported modestly higher sales in recent weeks. Factory rebates and financing incentives bolstered automobile sales. In addition, building materials suppliers saw an uptick in sales, surprising some of our contacts. Department stores and big-box retail sales grew at or slightly ahead of the pace noted in our last report, and some stores began hiring additional workers in anticipation of stronger sales ahead. A contact with an upscale department store chain said that because of good sales prospects they were opening a new store in the Washington area in August and would hire 200 people.

Services: Services firms reported that demand was flat in June and July. Several contacts characterized their customers as having a "wait and see" attitude due to the recent stock market slide, apprehension about terrorism, and concerns about additional corporate accounting scandals. Despite customers' concerns, some District services businesses saw a pickup in demand. Airports in Virginia said air travel had increased, a fitness center in Charlotte, N.C. said memberships were up, and a conference center in Rock Hill, S.C. said they were getting more calls and bookings. While current demand was mixed, firms remained optimistic about their prospects. Services firms added employees in June and July, as many looked for a pickup in demand in the months ahead. Prices in the services sector continued to rise at a moderate pace.

Manufacturing: District manufacturing activity generally expanded since our last report, although at a more moderate and uneven pace. Shipments and new orders rose sharply at tobacco and paper manufacturing facilities. A South Carolina paper producer said that because orders were stronger in June, his plant increased its payroll and was working employees overtime. But contacts in the furniture and textiles industries reported that their demand softened, in part because of diminished consumer confidence. Even though overall employment in the District's manufacturing sector slipped in recent weeks and the average workweek edged lower, manufacturers continued to indicate that they would increase their payrolls over the next six months. Manufacturers continued to report modest increases in product prices.

Finance: District loan officers said that lending activity rose only modestly in the weeks since our last report. Residential mortgage lenders reported that low interest rates continued to support mortgage demand at a high level. A banker in Greenville, S.C., said that attractive interest rates had caused "fence sitters" to move ahead with securing mortgages for new home purchases, as well as leading homeowners to refinance existing mortgages. He also reported an increase in home remodeling loans. Commercial lenders reported that the demand for business loans was somewhat higher in recent weeks, but they noted that the level of activity remained generally weak. Several commercial lenders suggested that businesses' concerns about corporate accounting practices and stock market declines had slowed their local economies. A banker in Richmond, Va., however, noted that some clients' projects—on hold since September 11th—were starting to move ahead. She also noted more lending to municipalities struggling with revenue shortfalls.

Real Estate: Residential real estate activity remained generally upbeat in recent weeks. A Washington, D.C., realtor said that housing sales continued to be strong and that sellers were generally receiving more than their listing price when properties sold. An agent in Lutherville, Md., also reported strong home sales, but noted that the month-to-month sales figures were a little more erratic than earlier in the year. A number of contacts reported that sales of higher-priced homes had slowed—a realtor in Columbia, S.C., characterized this segment of the market as "dead in the water" in that area. While some realtors said that weakness in the higher-priced market segment stemmed in part from a loss of wealth in the stock market, others believed that stock market reversals had bolstered real estate sales. A Fredericksburg, Va., realtor said that lousy returns on stock market investments had caused some people to "bail out" of stocks and into real estate. A Richmond, Va., realtor added that people simply felt safer investing in real estate than in the stock market right now.

Fifth District commercial leasing and construction activity changed little since our last report. Realtors attributed the sluggishness of commercial activity to ongoing uncertainty over economic prospects. The office sector was particularly stagnant in recent weeks. A contact in Columbia, S.C., noted that despite lease renewals by many firms, absorption rates have not increased in that area. Activity in the industrial sector was also generally flat—but the level of activity varied by space type and location. A Northern Virginia industrial broker reported that traditional warehouse space continued to generate more interest than "flex space"—an office-industrial hybrid. Retail sector activity was mostly subdued across most of the Fifth District, but pockets of strength were recorded in Virginia and South Carolina. Rental rates and vacancy rates generally stabilized across the retail and industrial sectors, but weakened somewhat in the office sector.

Tourism: District tourist activity strengthened further in recent weeks. Along the coast, hoteliers at Virginia Beach, the Outer Banks of North Carolina, and Myrtle Beach, S.C., reported that their bookings over the Fourth of July holiday were somewhat stronger than a year ago. A contact on the Outer Banks told us that construction of a large number of rental homes in the area had resulted in substantial rent discounting. A respondent in Virginia Beach reported that bookings for September and October were below the year ago level.

Temporary Employment: Temporary employment agencies across the District continued to report stronger demand for workers in recent weeks. Most contacts said that administrative and production workers were in particularly high demand, though they noted a trend toward shorter contract periods. Wages for temporary employees were little changed.

Agriculture: Persistent drought conditions severely stressed crops and pastures in many areas of the District in recent months. Virginia and North Carolina suffered through severe drought conditions; the governor of North Carolina has proposed that 54 counties in the state be declared disaster areas. Corn and soybean crops in the District have been particularly hard hit by dry conditions—over two-thirds of the corn crop in South Carolina was in poor to very poor condition. In addition, cattle farmers in North Carolina and Virginia reportedly culled livestock and hauled water due to poor pasture conditions and decreasing water supplies.

SIXTH DISTRICT - ATLANTA

Summary: Economic activity remained sluggish in June and early July, according to contacts from across the Sixth District. Merchants' sales were disappointing, but inventories remained balanced and the outlook for the third quarter is upbeat. Growth in the District's hospitality and tourism sector moderated as tourist traffic declined in parts of Florida. The factory sector remained mixed with lackluster new orders and limited spending on new technology. New car and truck sales in the District continued to lag behind national figures, although recent incentives improved sales. Single-family housing remained strong, but weakness in the commercial real estate market continued. Financial institutions noted modest improvement in consumer loan demand, and commercial loan demand remained soft. Labor markets were little changed, with few companies hiring on a permanent basis. Price pressures continued to be limited to insurance, healthcare, and steel.

Consumer Spending: Several District retailers reported a slight improvement in June on a year-over-year basis, but sales growth weakened somewhat in early July. Most contacts described inventory levels as balanced. Home-related product sales were strong across much of the region. Retailers remained cautious and continued to monitor inventory levels closely. The majority of contacts anticipate that sales during the third quarter will exceed year-ago levels. Auto sales were below year-ago levels, but SUV sales continued to support the market. A new wave of financing incentives helped improve sales.

Real Estate and Construction: Low mortgage rates continued to be a catalyst to District housing markets. Contacts reported that home sales and new home construction equaled or exceeded year-ago levels during June and early July. The strongest reports continued to come from Florida. Contacts noted that some consumers appear to be investing in homes rather than the stock market. The outlook for the third quarter remains upbeat. Sublease space and weak job growth continued to be a drag on District commercial real estate. Office vacancy rates remained at high levels, but some improvement in office and industrial leasing was noted in several markets. New construction remained largely limited to government and healthcare-related projects.

Manufacturing: Factory activity was mixed. Manufacturers were reportedly cautious about inventory accumulations, and several contacts observed that new orders were keeping pace with current sales. Producers of building supplies reported a lag in industrial sales, but several noted increased demand for household remodeling and repair products. Orders were sluggish for apparel producers. Contacts reported that expansions in the vehicle-manufacturing sector are expected to create about 3,300 jobs over the next few years. Vehicle parts suppliers were "swamped with orders," according to one report. A manufacturer of healthcare products noted an increasing factory workweek. Technology spending in the District was largely restricted to software upgrades, with new investments remaining largely on hold.

Tourism and Business Travel: Reports from the District's hospitality and tourism sector were not as robust overall as in recent months. Contacts in Miami indicated slower-than-expected summer activity. Although occupancy rates remained down from a year ago across the state, hotels were reportedly maintaining profitably by reducing staffing. Cruise ships continued to sail at full capacity without price discounting. Parts of Florida reported better-than-expected results because of a rise in the number of visitors driving to tourist destinations. However, contacts indicated that tourists were spending less, and the average duration of stay was shorter than it was last year. Some segments of the Louisiana gaming industry showed some improvement on a year-ago basis. Business travel remained weak.

Financial: Consumer lending increased moderately throughout the District, and problem assets remained under control in most areas. Banks continued to report little growth in commercial loan demand.

Prices and Labor: Most reports continued to indicate that firms were not adding significantly to payrolls. Increased hours and temporary staff hiring remained the rule for filling openings. Many expansion plans remained on hold. One report noted that the demand for temporary workers in manufacturing was higher than last year.

Price pressures continued to be strong for healthcare and insurance. One contact reported that healthcare costs were expected to increase by double-digits for the third year in a row. The tariff-induced increase in steel prices adversely affected some District manufacturers.

Agriculture: Rains in most areas of Florida helped build up needed soil moisture, but other District areas remained in need of more precipitation. Dry soil conditions affected the yield of cotton crops in northern Alabama. However, cotton growers were encouraged by higher market prices.

SEVENTH DISTRICT—CHICAGO

Summary. Reports from Seventh District contacts suggested that the pace of the region's economic recovery remained slow in June and July. Reports on consumer spending became more mixed in recent weeks, as sales results varied widely by retail segment. The demand for housing remained very strong, while conditions in nonresidential construction and real estate were still soft. The recovery in manufacturing was uneven across industry segments. Overall lending activity was buoyed by strong demand for residential mortgages, while business loan demand remained low. Labor market conditions were mixed across the District, and employers were reluctant to take on new hires. Crop conditions in the Midwest have varied widely but, on average, appeared substantially less positive than a year ago.

Consumer spending. Reports on consumer spending continued to be mixed but, on balance, demand appeared to have softened slightly. Some chain stores noted an improving trend in sales while others reported that results fell short of their plans. Most merchants said that consumers continued to spend on promotion items, and discounters again reported stronger sales results than general merchandisers. A large District auto group reported that sales were softer than anticipated in June. Sales picked up somewhat in early July with the reintroduction of zero-percent factory financing deals, though consumer response was less enthusiastic than last fall. A contact in casual dining indicated that nationwide industry sales had weakened since Memorial Day, and were down from a year ago. The softness was widespread across regions, although the Midwest was said to be weaker than most. Theater and cinema ticket sales were again strong, and one contact noted that this is "one of the best years in the company's history." This is one of the few areas where price increases have stuck with little resistance from consumers. Tourist travel in the region was flat from a year ago, and our contacts universally reported that Fourth of July weekend travel was very good. With few exceptions, significant competitive pressures reportedly kept prices in check.

Construction/real estate. Construction and real estate activities were again mixed by market segment, with the residential market remaining very strong and softness persisting on the nonresidential side. Existing home sales were up from a year ago, according to realtors in most areas, and price appreciation remained very strong. The market was said to be very active with listings keeping up with sales. The market for new homes was robust in most areas as well. A contact with one state builders association reported that "every single builder that I've spoken with is busy." A common complaint among homebuilders was the lack of land suitable for development. One contact warned that the rising cost of land was making it increasingly difficult for builders to offer homes that are affordable to first-time buyers. However, sales of luxury homes remained moribund according to both realtors and builders. Nonresidential activity was again relatively slow. Office vacancy rates continued to rise, but at a slower rate. Landlords were said to be offering more generous concessions up front, but the downtrend in rents appeared to moderate further. Contacts described commercial leasing activity as "trend less" and "stagnant."

Manufacturing. Reports from our manufacturing contacts suggested that the pace of recovery remained uneven across industry segments. Automakers reported that nationwide light vehicle sales had picked up and were "brisk" in July. The pricing environment remained very competitive, and some producers brought back zero percent financing offers to entice customers into showrooms. Due to strong sales, light vehicle production was up from a year ago and inventories were said to be at or near desired levels. A steel industry analyst indicated that there was a steady increase in steel production, as new orders were strong and inventories for some products remained lean. This contact also noted that prices for sheet steel products were still moving higher, but profitability for the industry remained elusive. A producer of gypsum wallboard forecast that 2002 would be the second best year ever for the industry's shipments, despite continuing weakness in nonresidential construction. Conditions in heavy equipment sectors were mixed, but generally softer than in our previous report. Manufacturers of heavy trucks noted that production slots were full through October, and they were no longer accepting orders for units equipped with engines that do not meet new EPA regulations scheduled to take effect October 1. Truck production is expected to drop off markedly after October, reflecting weak demand associated with substantial uncertainty over the costs of buying and operating the new engines. Demand for construction and mining equipment remained soft, but contacts did note some recovery in the demand for agricultural equipment. Reports from toolmakers were also mixed, with some contacts noting continued pessimism, while others saw "a light at the end of the tunnel."

Banking/finance. Overall lending activity appeared to pick up modestly, buoyed by a resurgence in mortgage refinancing. On the household side, nearly all of our bank contacts noted a big increase in applications for mortgage refinancing in recent weeks, with one referring to it as "refi mania." At the same time, strong home sales kept the demand for new originations robust as well. Reports on credit card usage were mixed, but generally indicated a moderate increase in volumes. Business loan demand remained sluggish, but contacts suggested that activity "was bottoming out." A contact with one large bank said that there remained "a hesitancy on the part of businesses to commit to capital expenditures." Credit quality on both household and business loans was reportedly unchanged, as were standards and terms for loans. Contacts from nearly all sectors of the economy suggested that the costs of most types of insurance coverage continued to rise. A large insurer based in the Midwest recently announced its second double-digit increase this year in homeowners rates, a move it blamed on increasing claims against property insurance.

Labor markets. Reports on labor market conditions were mixed, and contacts noted that employers were still reluctant to hire workers. With regard to the demand for staffing services in the Chicago area, one contact stated "I would have said two months ago there was a turnaround, but in the last month it has evaporated." There were a few reports of new layoffs in the District, especially in manufacturing. Contacts in some areas, however, noted a seasonal pickup in demand for light industrial and construction workers, as well as project managers. Wage pressures remained subdued, but contacts continued to report increases in non-wage labor costs, particularly for insurance.

Agriculture. Corn and soybean crop conditions varied widely across the District as of mid-July. Hot temperatures and scattered rainfall left many areas short of soil moisture as crops were entering the critical reproductive stage. Crop conditions in Iowa and Wisconsin were better than those in Illinois and Indiana. More generally, crop conditions in the major corn and soybean producing states appear much less favorable at this stage of the season than a year ago. At the same time, demand remained strong, resulting in higher cash prices for corn and soybeans in the past month. While this was a positive for crop farmers, it had a decidedly negative impact on the District's livestock and dairy farmers, who are experiencing considerable pressure on profit margins.

Eighth District - St. Louis

Summary

Economic activity in the District continues to recover. Manufacturers in a range of industries report plans to expand production and employment, and retailers report that sales improved somewhat in June and July. The residential real estate market continues to be strong throughout most of the District, particularly for low- and mid-priced homes. On the other hand, commercial real estate markets continue to be weak throughout the District. Although infrastructure construction remains steady, state-government fiscal problems are causing concern about the future. Loan demand was strong throughout the District in the second quarter, particularly for residential mortgages. In the agricultural sector, the recent wheat harvest was down significantly from last year and crop conditions are reported to be fair or good throughout most of the District.

Manufacturing and Other Business Activity

Overall, manufacturing in the District is still recovering. Manufacturers in the furniture, metal, aircraft, biomedical, and auto parts industries are among those who have announced plans to expand. Contacts note renewed optimism about the rest of the year. Several reports indicate that companies previously facing difficulty have been bought and reorganized. Nonetheless, some contacts note that the level of activity is still lower than it had been in the recent past. For example, one contact reports that barge activity on the Ohio River is down substantially from last year's level.

Retail sales have rebounded somewhat after a lackluster spring, which had been attributed to inclement weather. Accordingly, some retailers attribute the return of customers to the warm weather. While discount and moderate-priced stores continue to outperform other merchants, a number of these other merchants have posted sales that exceed expectations. Most layoffs in the retail sector are the result of cutting unnecessary or redundant positions. Automobile sales are a mixed bag as some dealers report strong sales while others have noted sales tapering off since May. Several dealers note that used and mid-range new cars remain relatively more popular.

Real Estate and Construction

Reports from most of the District's metropolitan areas indicate that residential real estate sales are strong compared with the beginning of the year, particularly for homes priced below $150,000. In contrast, sales volume has slowed over the last two months in northern Mississippi, and there is an oversupply of used homes in Louisville. Commercial and industrial real estate markets have remained sluggish. Contacts in Memphis and Louisville report a decrease in demand for office space, while lease rates for office space in Little Rock remain steady. During the first two quarters, the inventory for industrial space in St. Louis increased while the rate of absorption was negative and below its 2001 pace.

Residential construction opportunities have improved over last year as May year-to-date building permits were higher than a year earlier for most of the District. Commercial construction opportunities are increasing in western Tennessee, although contacts in Arkansas and Kentucky report fewer projects for speculative space and more projects for space that has already been leased before construction. State-funded infrastructure projects continue to provide steady demand to the construction industry, although state-government fiscal problems are causing a great deal of concern.

Banking and Finance

Total loans outstanding at a sample of small and mid-sized District banks were up by 3.8 percent between early May and early July this year. This increase stems from real estate loans which are up by 3.6 percent over the same period and loans to other commercial banks in the country, which were up by 1.4 percent. Commercial and industrial loans and loans to individuals also increased over the same period, growing by 1.3 percent and 1.2 percent, respectively. Total deposits at these banks were up by 3.8 percent. Contacts have reported a slight rise in bankruptcy filings and past-due loans. Overall, however, asset quality is reported to be good.

Agriculture and Natural Resources

The winter wheat harvest is nearly complete in most District states, with contacts in Arkansas, Missouri, and Illinois reporting test weights as fair-to-good. Significant yield reductions, resulting from a wet spring and weather-related diseases, caused the recent harvest to be at its lowest level in several years. The wheat yields in District states were 6 percent to 23 percent lower than a year ago.

Topsoil moisture conditions are reported to be adequate in Mississippi, with the other District states, most notably Illinois, reporting less-than-adequate moisture conditions. On average, most crops in Arkansas, Kentucky, Mississippi, and Tennessee are in good condition while those in Indiana, Illinois, and Missouri are in fair condition. Among the latter group of states, there is widespread concern among farmers about their crops, particularly corn and soybeans. The dry soil conditions, in conjunction with the current adverse weather, stressed the late-planted corn crop and may have lowered potential yields in some areas. In addition, the lack of rain in the soybean producing areas has caused the price for this crop to increase markedly between mid-June and mid-July. The unfavorable dryness that persists in the northern parts of the District has also been causing pasture conditions to deteriorate, with conditions in Tennessee generally in the worst shape.

NINTH DISTRICT--MINNEAPOLIS

The Ninth District economy appears to have expanded modestly from early June through mid-July. Agriculture, consumer spending, residential construction, tourism and manufacturing grew. Meanwhile, the energy and mining sectors were level and commercial construction contracted. From early June through mid-July, labor markets, wages and prices stabilized. However, significant price increases in insurance, plastics, steel and residential real estate were noted.

Construction and Real Estate

Commercial construction is slower than a year ago. Recent office vacancy rates are creeping higher in the Minneapolis-St. Paul area and are expected to rise at least until next year, according to a commercial real estate company representative. As a result, prospective tenants have recently found reduced rents and more space-improvement funds available. Contracts awarded for private building projects in Minnesota and the Dakotas decreased 17 percent during the three-month period ending in May compared with last year; however, road and bridge construction was up 24 percent. Furthermore, many large-scale construction projects are under way in the Upper Peninsula of Michigan, according to an official.

Residential construction is strong, while home real estate activity is steady. In the Minneapolis-St. Paul area, housing units authorized for June year to date increased 16 percent compared with a year ago. In May, more homes were for sale compared with the same period last year in the Minneapolis-St. Paul area, keeping residential sales activity steady but not as frenzied as a year ago, according to a realtors association representative. The pace of recent residential construction in Sioux Falls, S.D., is slightly ahead of a year ago, according to a building official; however, apartment vacancy rates are at the highest level since 1996 due to high levels of multifamily building over the past two years.

Consumer Spending and Tourism

Consumer spending is somewhat higher than a year ago. A major Minneapolis-based department store retailer reported that overall same-store sales in June were 4.9 percent higher compared with a year earlier. A manager at a North Dakota mall reported June same-store sales up about 4 percent over last year. Recent foot traffic was reported higher at a Minneapolis area mall compared with last year, while a manager at another Minneapolis area mall reported flat traffic and sales. However, a Minnesota-based leather products retailer reported that same-store sales at its chain of stores were down 6 percent in June compared with a year ago.

Auto sales in Montana improved in June compared with the previous few months, according to a Montana bank director. However, an automobile dealer association representative in Minnesota noted generally slower business in June compared with last year, particularly at dealerships located outside the Minneapolis-St. Paul area.

Tourism is strong in several areas. In the La Crosse, Wis., area summer tourism is off to a good start compared with last year, according to an official. Most hotels and resorts surveyed in Minnesota at the end of June by the state tourism office reported the same or higher occupancy than a year ago, except for the Minneapolis-St. Paul area, where about half of respondents reported lower occupancy levels. Tourists were recently evacuated from Deadwood, S.D., for two days due to forest fires; however, business recovered quickly according to a tourism official. Visits to Mount Rushmore were up 23 percent in June compared with last year.

Manufacturing

Manufacturing activity increased. A June survey of purchasing managers by Creighton University (Omaha, Neb.) indicated increases in manufacturing activity in Minnesota and the Dakotas. A Minnesota all-terrain vehicle manufacturer recently reported strong demand for its products. In South Dakota, a sewing plant plans to expand employment after receiving a recent order from the U.S. Department of Defense. A plastic products producer in the Upper Peninsula of Michigan is purchasing equipment and expanding employment as a result of increased orders. An emergency services equipment manufacturer in western Wisconsin plans to quadruple the size of its operations with a $2.9 million expansion, and a brewery recently increased output due to strong demand. However, a Minnesota brewery recently closed.

Energy and Mining

Activity in the energy and mining sectors is level. Early July district oil and natural gas exploration and production levels were about even with early June levels. Meanwhile, early July iron ore output is about level with the previous month, according to an industry spokesperson. However, a Montana platinum mine plans to expand output throughout 2002.

Agriculture

The overall agricultural economy has brightened since early June. Rains aided reservoir and irrigation systems, but the drought continues in parts of the district. An early June "perfect storm" in Montana should help provide the biggest wheat crop since 1997, according to a Montana bank director. Meanwhile, the U.S. Department of Agriculture reported above-normal progress for most district crops. For example, 50 percent of the Minnesota and 44 percent of the South Dakota soybean crop was blooming in mid-July compared with the five-year average of 35 percent and 32 percent respectively. However, about 40 percent of a large cooperative's sugar beet acres were damaged by recent flooding and poor springtime weather.

Employment, Wages and Prices

Labor markets remained at about the same level as the last report, with a mix of layoff and expansion announcements. A telecommunications company will lay off 400 Minnesota employees over the next few months. An electronics retailer recently announced plans to close its 400-employee distribution center in Minnesota. The closure of a western Wisconsin manufacturer of fitness equipment and small appliances will result in 100 job losses. A bank director reported that most company contacts do not plan to increase employment over the next few months.

In contrast, the expansion of a Minnesota furniture store could increase its staffing levels by up to 130 employees by next year. A Minnesota e-commerce company recently announced plans to add up to 90 employees to its sales department. A proposed call center in South Dakota would initially employ 150 workers, potentially expanding to 500 in five years. Furthermore, the number of initial claims for unemployment in Minnesota decreased about 8 percent in June compared with the same month last year.

Wage increases are moderate. A Montana bank director reported employers in northeast Montana expect to increase wages about 3 percent or lower. Hourly wages for district manufacturing workers increased 2.9 percent for the three-month period ending in May.

Price increases are modest, except in insurance, plastics, steel and real estate. Several bank directors reported little growth in overall prices. However, Minnesota's health maintenance organizations recently reported an increase in premium revenue per member by 14 percent over a year ago. A bank director reported recent significant price increases for plastics and steel compared with a year ago. The median price for a home in Minneapolis-St. Paul increased almost 7 percent in May compared with a year ago.

TENTH DISTRICT - KANSAS CITY

Overview. The Tenth District economy maintained an upward trend in June and early July, although there were still some signs of weakness. Residential real estate activity rose in most of the district, and manufacturing activity continued to improve. In addition, retail sales remained steady, and energy activity held previous gains. On the negative side, vehicle sales were weak prior to the reintroduction of incentives, and commercial real estate markets continued to soften. In the farm economy, drought conditions damaged pastures and spring crops in western parts of the district. Wage and retail price pressures remained largely subdued, although prices for some manufacturing and construction materials increased.

Consumer Spending. Most retailers in the district continued to report steady sales in June and early July. Sales appeared to be strongest at higher-end stores. Among merchandise categories, home furnishings performed best, while appliances and sporting goods showed some weakness. Apparel sales were mixed. Stores appear to have finally eliminated excess inventories and are now beginning to re-stock. Nearly all managers were optimistic about sales in coming months, particularly for the back-to-school season. Motor vehicle sales were generally weak in June, with dealers aggressively trimming inventories. Sales began to pick up in early July but only after the reintroduction of attractive financing incentives. Dealers remain very concerned about future sales and some have increased their advertising expenditures considerably in order to reduce inventories before the special financing ends. Tourism activity in the district appears to have largely returned to pre-recession levels outside of Colorado. In Colorado, occupancy rates at hotels and resorts were improving until the June wildfires disrupted the rebound.

Manufacturing. District factory activity showed further signs of recovery in June and early July, though firms were not as upbeat as a few months ago. Production moved almost even with year-ago levels, and fewer firms than in past surveys reported declines in employment from a year ago. Capacity utilization also remained higher than earlier in the year. On the other hand, the volume of new orders weakened somewhat, and expectations for future production were not as high as in the spring. Inventories declined in June but are expected to hold steady in coming months. Supplier delivery times continued to edge up.

Real Estate and Construction. Residential real estate activity improved in June and early July, but commercial real estate markets continued to weaken. Single-family construction rose in most areas and was considerably higher than a year ago in some places. Starts of entry-level houses were particularly strong. Builders expect construction activity to remain solid in coming months and are not expecting any problems in obtaining materials. Home sales were steady across the district, with strong sales of lower-priced homes continuing to offset somewhat weaker sales of higher-priced homes. Realtors expect these sales patterns to continue. Mortgage lenders reported a slight increase in demand for home loans, with both home purchases and refinancings edging up from the previous survey. Lenders indicated that the majority of borrowers who refinanced were seeking to reduce their monthly payments rather than cash out. Mortgage demand is expected to remain steady through the fall. Commercial realtors reported further weakening in district office markets in June and early July. Vacancy rates continued to edge up across the region, while construction, sales, and prices of office space continued to decline. Most realtors expect further softening in office markets in coming months.

Banking. Bankers report that loans fell and deposits edged up since the last survey, reducing loan-deposit ratios. Demand decreased for all major loan categories except home equity loans, which held steady. Some bankers attributed the decline in loan demand to the uncertain economic outlook and increased caution on the part of borrowers. On the deposit side, NOW accounts remained unchanged but all other categories rose. All respondent banks left their prime lending rates unchanged, and most banks also held their consumer lending rates steady. A few banks tightened their lending standards.

Energy. Energy activity in the district remained strong. The count of active oil and gas drilling rigs in the region held steady in June and early July after rising considerably in May. Natural gas producers in Wyoming, however, have experienced some downward pressure on earnings in the past few months. While natural gas prices in most of the country have remained flat since April, prices in Wyoming have fallen sharply. District sources attribute the price decline in the state to the combination of increased local production and a shortage of pipeline capacity to transport supplies to national markets.

Agriculture. Drought conditions persisted in much of the district in June and early July. As a result, the recently harvested wheat crop was below average and spring-planted crops were stressed. Pastures have been extremely dry, forcing cattle ranchers to seek other forage supplies and sell some of their breeding stock and young calves. However, in the easternmost areas of the district, spring planted crops and pasture conditions have been favorable. District bankers expect lower farm incomes this year due to drought-related crop losses and lower livestock prices. Bankers indicate they will continue to watch farm loan portfolios closely, as farm financial conditions will depend largely on government payments and crop insurance.

Wages and Prices. Wage and price pressures remained generally subdued in June and early July, although some materials prices rose. District labor markets were quite slack, and layoff announcements increased slightly from the previous survey. However, employers continued to have difficulty hiring nurses, skilled construction workers, and certain types of IT workers. Some retailers also reported they were beginning to have problems finding experienced salespeople. Wage pressures were generally nonexistent outside of these fields, but employer benefit costs continued to increase, due primarily to rising health care premiums. Many firms reported they were planning to pass premium increases on to their employees or were exploring other ways to limit their health insurance contributions. Retail prices remained basically flat and are expected to stay unchanged in coming months. Builders reported they were paying slightly higher prices for materials, particularly for lumber. They expect these increases to taper off in the near future, however. Some manufacturers reported further rises in steel prices, but prices for most other materials were unchanged. Many managers expect slightly higher material prices over the next few months.

ELEVENTH DISTRICT—DALLAS

Eleventh District economic activity grew very slowly in June and the first half of July. Caution is percolating through the economy, with respondents expressing concern about the stock market, recent corporate scandals, and terrorism. Several contacts said their firms have customers who are interested in doing business—are financially ready to do deals—but need more confidence to go forward. Manufacturing and service sector activity was expanding slowly. Retail sales were weak, and construction and real estate activity remained soft. Energy activity flattened, after having increased strongly in the spring. Contacts in the financial services industry said consumer lending was showing signs of softening. Heavy rain improved agricultural conditions.

Prices and Labor Markets. Most contacts reported little price pressure, and that inventories of most goods were at desired levels. High insurance costs continue to be reported as a widespread concern. Crude oil prices hovered between $24 and $26 per barrel in June and the first half of July. Although wholesale prices for gasoline are about seven cents per gallon higher than a year ago, gasoline consumption is up about 1 percent above last year's levels. Although demand has strengthened, inventories of gasoline are high because the warm winter led to a buildup of heating oil inventories, which encouraged refiners to turn to gasoline production early this year. Natural gas prices continued to drift down in recent weeks pulled down by inventories that are nearly 20 percent above the five-year average. Barring unusually hot weather, natural gas inventories are on course to reach record levels by late summer. Prices are up for basic petrochemicals, such as ethylene, propylene and styrene, and for plastics, such as polyethylene, polypropylene, polystyrene and PVC. Contacts were uncertain if recent price increases were sustainable for petrochemicals because it is unclear if the price increases were the result of improved fundamentals or high levels of plant outages. Paper producers say prices are up for all types of products, partly because of higher prices for plastics.

Most industries reported little change in labor markets. The temporary service industry said that wages are flat to declining, and competition is pushing down fees as much as 15 percent. High tech firms reported that, while the market for programmers and other employees has loosened substantially, the job market for engineers is very tight, and employees are no longer willing to accept stock as compensation.

Manufacturing. Manufacturing activity continued to expand weakly. Contacts said that the high tech industry is clearly at the bottom, but the speed of the recovery differs by product. While telecommunications firms generally believe the worst is over, contacts reported no signs of improvement—particularly for wired devices—and expect to bump along the bottom for a while. Demand for wireless devices and consumer electronics is up, although computer sales have been weak. The semiconductor industry is clearly in recovery, according to contacts, who said that sales growth is expected to be positive by the end of summer and typically rebounds quickly. Demand for chips to supply consumer electronics, wireless communications equipment, and automobiles is rising, both because demand for those products is increasing but also because more chips are going into each product.

Demand for construction-related materials was mixed. Cement activity was slow due to heavy rains, but contacts expect demand to pick back up soon. Demand for fabricated metal also softened over the past month. Sales were up for clay and brick, with strong demand for residential and government building. Lumber and glass producers reported little change in sales. Demand for primary metals has been improving slightly according to contacts, who say activity is stronger than a year ago. Steel sales have picked up the strongest, thanks to tariff protection.

Demand is up for plastic products. In contrast, Refineries reduced capacity utilization to control stocks, which are high. Refiners' margins have improved from the weak levels of this winter but are still well below normal.

Sales of food and apparel products were up. Paper producers say demand has been slowing over the past few months, and customers are reluctant to buy anything other than what is necessary.

Services. Service sector activity continued to slowly improve. Temporary service firms say demand is up considerably from a year ago. Activity is strengthening to supply light manufacturing and distribution and call centers, but demand from the financial and IT sectors remained weak. Temporary firms said that intense competition is keeping profits down despite increased activity. Law firms reported that litigation and bankruptcy activity remained strong, and there are signs of a slight pick up in some other areas. But corporate and transactions work remained slow. Accounting firms reported a pickup in audit work and an increase in customers as a result of the collapse of Andersen. In their view, many clients are unprofitable, and business in mergers and transactions is weak.

Railroads reported a general pickup in activity, although construction shipments have been weak. Trucking shipments have been weak, particularly of construction materials. Demand for air travel remains weak, and some airlines continue to report double-digit declines in passenger loads in comparison with last year, which has led to large revenue shortfalls. Further employment cuts are expected. Contacts say government guarantees are distorting the industry because they are keeping the less efficient airlines alive.

Retail Sales. Retail sales were soft in June and the first half of July. Intense competition has led to a struggle for market share. Inventories are in good shape, according to most contacts, who say that they do not expect a lot of promotions to reduce stock. Retailers reported that consumers are buying only what they need and see no signs that spending will pick up. Some firms are reducing purchases because sales have been below expectations. Auto sales picked up strongly in Houston and less so in the rest of the state. Dealers credited financing incentives and said that price competition is intense.

Financial Services. Deposits increased moderately despite declining deposit interest rates, which contacts attribute to uncertainty about financial markets. Lending activity was mostly unchanged, but consumer lending—which has been the strongest category—is showing signs of slowing. Commercial and industrial lending remained weak, and market-related activities, such as mergers and acquisitions, continued their strong negative trend. Contacts were less optimistic about the outlook than they have been for many months.

Construction and Real Estate. Construction and real estate activity remained soft. Office markets continued to flounder, with weak leasing demand and several large corporations looking to unload properties. Contacts in Houston said that uncertainty has led some tenants to limit lease renewals to one year. Office rents in the previously "hot" areas of Dallas have dropped 50 percent from a year ago. Residential markets have been mostly unchanged. Low-priced homes still fare the best, but builders reported that competition is stiff and price concessions are deep. Contacts said that money is available for investment opportunities because recent losses in equity markets have boosted the attractiveness of real estate investments.

Energy. Drilling activity leveled out in June and early July after several weeks of solid improvement. Activity at large energy firms has continued at roughly the same pace, but smaller independent firms have pulled back in recent weeks, cautious about high inventories and slower than anticipated demand for oil and natural gas. Despite improvements earlier in the year, energy service firms report that the industry is very competitive and that there is no pricing power.

Agriculture. Heavy rainfall improved crop growth and livestock conditions in most areas, greening up pastures and replenishing reservoirs. While the rains caused severe flooding with crop and livestock losses in some parts, dry conditions remain a concern in parts of South and West Texas. Corn, grain and cotton prices were up, while cattle prices fell. Contacts are optimistic that recent exchange rate changes should help exports.

TWELFTH DISTRICT–SAN FRANCISCO

Reports from Twelfth District contacts suggest that economic activity continued to expand at a moderate pace in most of the region in June through mid-July. Respondents reported little change in prices for most consumer goods and services, though most noted further increases in housing prices. In labor markets, contacts noted little upward pressure on wages, but higher costs for health care and other insurance. While contacts noted that consumers spent cautiously during the survey period, households also continued to respond to discounting in the retail trade and service sectors. The survey responses pointed to some improvement in high-tech manufacturing, particularly semiconductors. Overall, however, businesses were cautious about upgrading and expanding facilities, equipment, and software. Conditions in the District's agricultural sector improved in recent weeks. Commercial real estate markets remained weak, with vacancy rates increasing slightly. Residential markets generally were solid; conditions ranged from good with some early signs of cooling to still hot in heavily populated Southern California. Bank contacts indicated that demand was strong for household loans but weak for business loans.

Prices and Wages

District respondents observed little upward pressure on wages and prices in June through mid-July. Discounting held down final sales prices on many retail products. On balance, producers' input prices held steady, except for spikes in wholesale electricity prices. Contacts also noted ample labor supply and stable wages in most areas. However, respondents indicated that health care and other insurance costs rose further during the most recent survey period.

Retail Trade and Services

Responses to the most recent survey indicated growth in overall sales for the retail trade and service sectors was moderate in recent weeks. Consumers were cautious in their spending for most retail goods and services in June through mid-July. However, contacts noted that new vehicle sales were boosted by aggressive pricing practices. Demand for major home appliances and remodeling services generally remained robust in the District; purchases were advanced in part by low interest rates and strong home sales. Most respondents indicated that inventories for retail goods were stable, though concern about a potential longshoremen's strike on the West Coast reportedly prompted an acceleration of deliveries of imports by some retail businesses.

Contacts noted generally improved conditions in the District's travel and tourism sectors. Respondents observed an increase in travel generally; however, hotel occupancy rates still were below year-earlier levels in several areas, including California and Hawaii.

Manufacturing

In the manufacturing sector, respondents reported some signs of improvement in recent weeks, notably in the semiconductor industry. Respondents noted a pickup in orders and sales for most varieties of semiconductors. Among semiconductor producers, inventories reportedly were flat, capacity utilization rose steadily, and prices were flat to up slightly. Prices for high-tech products more generally were soft. Contacts also noted ongoing weakness in the telecommunications industry, with depressed prices and profits leading to additional downsizing. In aerospace, defense contracts were a plus for the economy of Southern California, while weakness in commercial aircraft manufacturing held back growth in the state of Washington.

Most respondents indicated that inventories remained stable during the recent survey period. They also noted little evidence of changes in manufacturers' inventories or shipping patterns in response to concerns about a potential strike at West Coast ports. Several contacts noted that the weaker dollar appeared to be boosting exports.

Agriculture and Resource-related Industries

Conditions in the District's agricultural sector generally improved in June through mid-July. Respondents reported higher prices for various nuts, fruits, and dairy and forest products, although lower prices persisted for cotton, wine grapes, logs, and cattle. Contacts indicated that the weaker dollar has fueled District export activity in recent weeks. Fires and drought adversely affected ranchers in parts of the District. Electricity demand rose in the most recent survey period, and wholesale spot electricity prices spiked as summer temperatures soared throughout the region.

Real Estate and Construction

Respondents continued to report disparate conditions in District real estate markets in June through mid-July. Commercial real estate markets deteriorated further, while most residential markets remained relatively solid. Contacts noted that commercial office vacancy rates rose slightly during the current survey period. Lease prices declined or remained flat throughout the District, most notably in high-tech centers in California, Washington, Oregon, and Idaho. Construction costs for commercial buildings in several District states continued to fall.

In contrast, demand for residential real estate in the District generally remained solid in June through mid-July. Conditions were very robust in heavily populated Southern California, where house prices and building activity rose. Contacts in Hawaii also indicated demand for residential real estate was strong. Respondents in most other areas reported that home sales and prices rose, though less rapidly in recent weeks than earlier in the year. Contacts reported some softening in selected markets for high-end housing. In addition, in parts of the District, respondents noted rising vacancy rates and declining rents for multifamily and other rental housing units. Overall, residential construction activity continued to rise in the District.

Financial Institutions

The District's financial sector remained healthy in the most recent survey period. Contacts reported that bank earnings and asset quality were sound. Respondents noted strong household demand for credit. However, demand for business loans was weak, as businesses remained cautious and continued to delay capital investments.