



January 15, 2003

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Summary

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Prepared at the Federal Reserve Bank of San Francisco based on information collected before January 7, 2003. This document summarizes comments received from businesses and other contacts outside the Federal Reserve System and is not a representation of the views of Federal Reserve officials.

Reports from the twelve Federal Reserve Districts indicated subdued growth in economic activity from mid-November through early January, with little change in overall conditions relative to the last survey period. Most Districts characterized growth as "sluggish" or economic activity as "soft" or "subdued." The weakest report came from Dallas, where economic activity "remained anemic." As in the last survey, conditions in the New York, Philadelphia, and Cleveland Districts were more favorable overall than in other Districts, with each, especially New York, describing various signs of improvement.

Reports on consumer spending were consistently weak, with disappointing holiday sales that, in nominal terms, mostly were at or below last year's levels. Automobile sales surged at year-end in response to favorable sales incentives. Manufacturers expanded production a bit on balance, with notable gains for defense-related and biomedical products. Providers of nonfinancial services saw little change in existing weak demand, and business travel remained slow, although there were some reports of improved performance in the tourism sector. Home sales and residential construction activity remained at high levels but slowed a bit in some areas, and the widespread overhang of commercial real estate persisted. Agricultural production was hampered by adverse weather in some areas and performance was mixed. Extraction activity in the energy sector responded very little to sharp increases in energy prices. Bank lending continued to expand in most Districts due to strength in consumer and real estate borrowing. Labor demand was mostly flat, and despite rising costs for employee benefits and some inputs, increases in employee compensation and final prices were held down by competitive supply conditions.

Consumer Spending

Most Districts reported disappointing retail sales revenues during the survey period, with holiday season spending that was flat or down a bit compared with spending in the previous year. In Cleveland, sales were "very poor," with most respondents reporting declines of 1 percent to 10 percent from year-earlier levels; San Francisco reported "lackluster" sales that were "well below [retailers'] expectations." Most other Districts saw flat sales, although Richmond and Minneapolis noted scattered reports of solid sales growth, largely due to strength in post-Christmas purchases. A relatively short holiday season and inclement weather in some areas played small roles in holding sales down.

In most areas, sales were stronger at large discount chains than at traditional, higher-priced department and specialty stores. Consistent with these observations, substantial discounting

on holiday retail sales items was reported in all Districts, with Chicago explicitly noting deeper discounting compared with a year earlier. New York and Philadelphia reported moderate accumulation in retail inventories, but other Districts reported generally balanced inventories, due to a combination of conservative planning and the dominant role of low prices rather than low sales volume in determining weak nominal sales revenues.

Among product lines, the strongest holiday sales were recorded for consumer electronics and toys. Automobile sales showed signs of weakening in some areas, but according to Philadelphia, Cleveland, and Chicago, favorable year-end financing and price incentives produced a sales flurry in late December, lifting overall sales to high levels for the survey period.

Manufacturing

The manufacturing sector continued to struggle with weak demand and excess capacity, although, on balance, slight improvement was evident. The strongest report came from New York, where manufacturers statewide reported increases in new orders, shipments, and hours worked and were "overwhelmingly optimistic" about the near-term outlook. Overall activity was flat to up slightly in most other Districts. However, Kansas City reported weakened activity in December after signs of stabilization earlier, and St. Louis reported widespread announcements of employment cuts among manufacturers of durable and nondurable products.

Demand for high-tech products was flat or improved a bit in Dallas and San Francisco, with the latter reporting increased sales of semiconductors for use in wireless technologies. Boston, Atlanta, Kansas City, and San Francisco cited sales gains for pharmaceuticals, medical equipment, and defense-related equipment. Manufacturing activity increased slightly in the Minneapolis District, with expanding capacity and production levels reported in the heavy machinery, metals, and electronics sectors. Automobile manufacturers in the Cleveland and Chicago Districts faced mostly stable demand, with a sales surge at the end of the year helping to bring inventories down from November's excessive levels. Declines in construction-related manufacturing were reported in Chicago and Dallas, and Richmond reported weak demand conditions for apparel manufacturers.

Most Districts reported little or no increase in capital spending by manufacturers. Atlanta noted declining demand for capital goods, and Kansas City indicated that capital spending fell in December after having firmed in October and November. Looking ahead, Philadelphia reported that the number of firms intending to boost capital spending in the first half of 2003 fell recently, and capital spending among manufacturers in the San Francisco District is being held down by excess capacity that is expected to persist for six months or more at the current pace of expansion.

Nonfinancial Services

Demand for business and professional services was somewhat weak and, overall, exhibited little change from the previous survey period. Philadelphia and Richmond described overall demand for services as "flat" or "steady." Dallas noted slow demand for accounting and legal services, and in the San Francisco District demand for advertising and related media services was soft. Boston reported good sales and revenues for insurance companies but noted that poor investment results kept hiring and capital spending frozen. Demand for trucking services remained strong in the Cleveland District despite a slowdown in December that was larger than the usual seasonal lull, and St. Louis reported steady demand for trucking but uneven profits due to rising fuel costs. Relative to seasonal norms, hiring or

planned hiring of temporary service workers was slow in Philadelphia, Richmond, and Dallas. By contrast, New York reported "brisk," broad-based hiring of temps in December.

Performance indicators in the travel and tourism sector were mixed. New York reported higher hotel occupancy and room rates compared with a year earlier. In the Atlanta District, hotel bookings in tourist areas have climbed back near their levels from the year 2000, although convention business in Atlanta has been hampered by persistent weakness in business travel. Atlanta and Richmond indicated that travelers are delaying travel plans to an unusual degree, and New York noted that recent figures on advance ticket sales for Broadway theaters were running 15 percent below a year earlier. Because of favorable weather conditions, early season ski receipts were excellent in the Richmond, Kansas City, and San Francisco Districts. However, Richmond reported weakened tourism in coastal areas, and Minneapolis reported sparse snow and a slow start to its winter sports season. In the San Francisco District, hotel occupancies have returned to normal in Hawaii but have been low elsewhere. Demand for airline services generally remained weak, although Dallas noted that holiday travel for some airlines was better than expected.

Real Estate and Construction

Residential construction activity and home sales remained at high levels in most Districts, although there were numerous reports of slight cooling in market activity. Reported activity was strongest in the Richmond District, where growth in home sales remained strong and the housing market was described as "tremendously active." Market activity was down somewhat in the Boston, New York, Cleveland, Chicago, Kansas City, and San Francisco Districts, due in part to normal seasonal slowing. St. Louis indicated that home demand may be leveling off. In Atlanta, home sales fell in December after an increase in November. Construction activity was at "low levels" in the Dallas District, although lower-priced homes (below \$250,000) sold "briskly." Boston, Atlanta, and Chicago also reported stronger demand for mid- and entry-level homes and condominiums than for more expensive residences.

The markets for commercial real estate continued to exhibit substantial slack in all Districts. Richmond and St. Louis described demand for office and industrial space as "sluggish" or "slow," while office vacancy rates increased slightly in Minneapolis-St. Paul, the city of Chicago, and parts of the Kansas City District. In the Cleveland District, commercial building activity remained at low levels, but builders reported a significant increase in the number of prospective projects. Minneapolis reported low vacancy rates for retail space and a corresponding increase in planned retail construction. Although San Francisco reported a decline in office vacancies in Los Angeles, contacts from that District and Dallas expect little overall change in commercial construction activity over the next two years.

Agriculture and Natural Resources

Agricultural output and performance was mixed across Districts, as adverse weather conditions hampered agricultural production activity in some areas. Chicago reported high yields and high prices for a variety of crops. There and in the St. Louis District, the value of farmland rose markedly, and bankers in the Kansas City District reported good credit quality for their farm loan portfolios. San Francisco noted improved sales of agricultural products, due in part to increased overseas demand spurred by the weaker dollar. By contrast, Minneapolis reported deterioration in performance in the agricultural sector. Moreover, heavy rain and otherwise inclement weather limited yields and production activity for a wide variety of crops in the Richmond, Atlanta, Chicago, and Dallas Districts, while lack of moisture is likely to limit yields for the winter wheat crops in Minneapolis and Kansas City.

Activity in the energy and mining sectors was flat or up slightly on net. Mining activity in the Minneapolis District continued at high levels. Minneapolis and Kansas City reported no change in extraction activities for oil and natural gas, and Dallas reported only a slight increase, despite a sharp rise in the prices of oil and natural gas. In addition, Dallas noted that inventories of natural gas and crude oil were well below year-earlier levels.

Financial Services and Credit

Loan demand was up on net, mainly reflecting strength in consumer and real estate lending. Business loan demand remained somewhat depressed in the Cleveland, Richmond, Chicago, and San Francisco Districts, and it fell further in Dallas. Kansas City reported a slight weakening in all loan categories and tightened credit standards. By contrast, Philadelphia reported modest increases in all categories. Contacts in New York and St. Louis saw a pickup in commercial and industrial loans, with New York reporting tightened credit standards for that category. Household loan demand remained strong in most areas, especially for home financing. However, household loan demand fell a bit in Atlanta, and both demand and quality were quite weak for household loans in Dallas.

Employment and Wages

In most Districts, firms remained very cautious in their hiring decisions and most categories of labor were in ample supply. Continued layoffs in a variety of industries were reported in several Districts, most notably St. Louis and San Francisco. The labor market in New York was described as "slack" overall, despite a reported increase in hiring of temporary services workers. Among Districts, only Minneapolis reported some tightening in labor markets. In Cleveland, labor markets were "stable." Upward wage pressure was described as "subdued" in Chicago and Kansas City and restrained by a weak labor market in San Francisco. Minneapolis reported modest wage increases (about 2 percent) compared with a year earlier, and Boston noted that some firms plan to ease restrictions on pay increases in 2003. Kansas City noted that the only categories of labor in short supply were health-care workers and some construction tradesmen, and Atlanta reported double-digit yearly wage increases for hospital workers. Contacts in Atlanta and Minneapolis cited sharp increases in employer costs for employee health coverage. Chicago and San Francisco reported that firms are responding to increased health costs by passing on a portion to employees through rising direct contributions or reductions in other components of compensation.

Prices

Despite rising costs for energy and other inputs, upward movement in the prices of final goods and services was quite limited. Chicago noted rising input costs for steel, packaging, and electronic components, but pointed to "fierce competition" as the main factor holding down prices for final goods. Kansas City also pointed to rising materials costs for manufacturers, although it noted that steel prices fell recently and prices of finished goods continued to decline. Several Districts reported a sharp increase in fuel costs in December. As noted by Dallas, however, stiff competition limited the impact of rising energy costs to reduced profit margins on some intermediate goods rather than increased prices of final goods.

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