



June 11, 2003

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Summary

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Prepared at the Federal Reserve Bank of Dallas and based on information collected before June 2, 2003. This document summarizes comments received from business and other contacts outside the Federal Reserve and is not a commentary on the views of Federal Reserve officials.

Although reports from the twelve Federal Reserve Districts indicated some signs of increased economic activity in April and May, conditions remained sluggish in most Districts. No District report suggested that economic conditions had deteriorated since the last Beige Book. Economic activity increased or showed signs of improving in the Dallas, Kansas City, New York, and Minneapolis Districts. The Philadelphia and Cleveland reports characterized activity as mixed, while other Districts generally saw sluggish, subpar, or subdued economic growth. The unwinding of war-related concerns appears to have provided some lift to business and consumer confidence, but most reports suggested that the effect has not been dramatic.

Consumer spending remained lackluster overall. Retail sales rebounded as the hostilities in Iraq subsided, but sales remained below the level of a year ago. Manufacturing activity was mixed, with some Districts reporting signs of improvement since the last Beige Book but others still seeing declines in orders. Service sector reports, although limited, suggested sluggish activity overall. Low mortgage rates continue to stimulate residential construction and home sales in most Districts, but commercial construction and real estate markets were still weak. The energy industry continued to strengthen. Agricultural production was impaired by wet weather in some areas. Most Districts continued to report weakness in labor markets and some downward pressure on wages, although benefit costs continued to increase.

Consumer Spending

Overall consumer spending was soft in April and May. Retail sales picked up some after subdued sales in March, but most reports indicated that sales remained below the level of a year ago. A few Districts noted that retail sales did not pick up as much as expected after the winding down of hostilities in Iraq. Wet weather was blamed for having damped sales in the Chicago, Cleveland, New York, Philadelphia, and Richmond Districts, but the very recent wet weather had a positive effect on foot traffic and sales in the Boston District. Most Districts indicated that inventories are in line with expectations, although a few Districts said inventories were on the high side, particularly apparel.

The outlook for consumer spending was described as cautiously optimistic. The Boston District reported that most contacts are less concerned about economic uncertainties than in previous months and anticipate that sales will increase modestly in the next few months. Retailers in the Richmond and Kansas City Districts also expressed optimism about sales in

coming months, noting that they are planning to hire summer help. However, contacts in the Dallas and Philadelphia Districts expressed caution that sales would not pick up significantly until employment conditions improve.

Lower selling prices were reported by the Dallas, New York, and Philadelphia Districts, and widespread promotional activity and discounts were reported by the Atlanta District. The Boston and Dallas Districts noted that retailers continue to focus on ways to reduce their costs and become more efficient--using such strategies as improving their marketing, investing in faster cash registers, and increasing the use of part-time workers.

Auto sales were mixed in April and May. Sales weakened since March in the Chicago, New York, and San Francisco Districts but improved in the Atlanta, Kansas City, and Philadelphia Districts. Sales were below the level of a year ago in the Boston, Cleveland, Kansas City, Philadelphia, and St. Louis Districts. Most Districts reported that dealer inventories have risen above desired levels. Some new incentives have been added, but contacts in the Philadelphia and Cleveland Districts suggested that consumers do not appear to be as responsive to the current offers as automakers and dealers had hoped.

Manufacturing

Manufacturing activity remained mixed. Three Districts--New York, Minneapolis, and Cleveland--reported an increase in manufacturing activity in April and May although three others--Philadelphia, Richmond, and Boston--indicated deterioration since the last report. The remaining six Districts reported little change from conditions that continued to be characterized as "sluggish," "weak," "soft," or "mixed." Still, four of those Districts reported signs of improvement or optimism about future activity.

Boston, Atlanta, and Dallas noted that production related to defense and construction activity remained among the bright spots in the manufacturing sector. San Francisco noted strong demand for advanced technology production. Energy-related manufacturing activity in the Dallas District remained relatively strong.

At the same time, the Richmond District's traditional manufacturing industries--textiles and furniture--recorded particularly sharp declines in April and May. The Chicago District reported that automakers said sales of light vehicles slowed nationwide in May, and inventories remained high; Cleveland noted a sharp cutback in motor vehicle production. The Chicago and Cleveland Districts also reported that, despite an increase in demand for specialty steel, steel shipments slowed early in the second quarter. Due to limited demand for new planes by the airlines, the San Francisco District reported that production of commercial aircraft has dropped to the lowest levels since the mid-1990s.

Services

Airline traffic has steadily increased in recent weeks, according to the Dallas District but, with airline capacity abundant, expectations are for a summer with low fares and intense competition. Airlines are carrying fewer passengers than a year ago and are continuing to cut costs through additional layoffs.

The Cleveland District reported that demand for trucking and shipping was flat in May compared with April and slightly lower than one year ago. In the St. Louis District, business has picked up recently for midsize to large trucking firms because several smaller firms have gone out of business. The Dallas District reported an improved outlook for trucking companies and an increase in rail shipments. Contacts in the San Francisco District note that fears about the spread of SARS had no discernible affect on overseas shipping activity.

District reports on the temporary employment industry are mixed. In the Boston District, half of the temporary employment firms contacted reported an improvement in business in the first quarter, with demand for workers in health care and selected financial services up, but light manufacturing still weak. In the New York District, an employment agency specializing in office jobs has also seen a pickup. Temporary staffing firms in the Dallas District report that demand has steadied. However, the vast majority of temporary help industry contacts in the Chicago District said that new orders fell in recent weeks, and those in the Richmond District reported lukewarm demand for workers in recent weeks.

Reports on tourism and travel activity were also mixed. Tourism activity was soft in the Minneapolis District, declined modestly in the Richmond District, but picked up seasonally in the Boston District. In Chicago, tourism remained fairly steady, and hotel occupancy rates improved slightly in some areas. Although tourism was weaker than expected at Rocky Mountain ski resorts in the Kansas City District, summer bookings at family destinations are solid. Concerns about the SARS epidemic in East Asia reduced business and leisure travel in the San Francisco District in recent weeks. In the Atlanta and San Francisco Districts, increases in domestic tourism helped offset a decline in the number of overseas arrivals. Hotels in the Atlanta District continue to struggle because of the low volume of business travel. The Dallas District reports that hotel industry occupancy is 4 percent to 5 percent below a year ago.

Construction and Real Estate

Residential real estate markets and construction activity strengthened in the Atlanta, Chicago, Cleveland, Kansas City, New York, Philadelphia, Richmond, and St. Louis Districts and was still "solid" in the Minneapolis District. In some instances, sales growth was very strong. For example, in April and May, many homebuilders in the Cleveland District reported sales increases of more than 10 percent over the high level of sales one year ago. In some areas of the Richmond District, home sales in recent weeks displayed "unprecedented strength," including real estate agents reporting their best sales growth in more than twenty-five years. However, inventories of unsold homes in late April and May were higher than a year ago in cities in the Kansas City District and were at record levels in Denver. In the Dallas District, new home building continued to lose steam, and sales of existing homes were very weak--contacts there say that it will take new jobs and increased confidence to stimulate demand for new homes.

Overall commercial real estate continues to be weak, with only scattered indications of conditions stabilizing at a low level. The Boston District has seen high and rising office vacancy rates and falling rents. Office vacancy rates have also edged up in suburban Philadelphia. Nonetheless, both Districts reported an increase in purchases of office buildings by institutional investors and real estate investment firms. New York's office market has shown signs of improving recently, after having weakened in the first quarter. Brisk leasing activity in Lower Manhattan--largely from the health sector--pushed that area's vacancy rate down sharply to its lowest level in one year. Commercial leasing and construction activity in the Richmond District was generally flat in recent weeks, but the retail sector was one of the bright spots in recent weeks.

Banking and Finance

Lending activity continued to increase, mostly for refinancing residential mortgages. The Chicago District reports that many households appear to be taking advantage of refinancing to pay down other debt, which is limiting growth in credit card balances. Business lending increased in the Dallas, Cleveland, and Philadelphia Districts, but was weak in the Atlanta

and Chicago Districts and in most of the San Francisco District. The Richmond District reports no signs of a pickup in commercial lending any time soon.

Most Districts reported little change in loan delinquencies. The Cleveland District noted a few reports that credit quality had slipped, and bankers in the Philadelphia District expect commercial loan quality to slip in the second half of the year because revenue growth for many business borrowers has been weaker-than-expected. However, the Chicago District indicated that the credit quality on commercial loans was improving modestly, while the San Francisco District reported that the credit quality of bank loans was generally stable to slightly improved. A mild increase in residential mortgage foreclosures was reported in the Atlanta District, while the Dallas District reported a May spike in home foreclosures in the Dallas-Fort Worth area. Banks in the St. Louis District reported that they had tightened lending standards for small firms.

Agriculture and Natural Resources

Wet weather delayed spring planting and other farm activity in the Atlanta, Chicago, Kansas City, Richmond, and St. Louis Districts. The heavy rains damaged crops in some areas, such as in the Richmond and St. Louis Districts, where contacts expressed concerns about reduced crop quality. But the moisture was welcomed in the Atlanta, Chicago, and Minneapolis Districts, where rainfall improved the outlook for yields. Conditions remain too dry in the Dallas District, where cotton planting was delayed because of insufficient moisture to germinate seed. The San Francisco District noted that sales were strong for beef cattle and for most crops, in part because the depreciation of the dollar boosted demand. The Atlanta District reported a bumper winter wheat crop. The Chicago and Minneapolis Districts reported that milk prices are very low.

The energy industry continues to strengthen, according to the Dallas, Kansas City, Minneapolis, and San Francisco Districts. Drilling activity picked up in response to robust demand for oil and natural gas. Contacts in the Dallas and Kansas City Districts expect drilling and related activity to continue to grow through the end of the year. The Minneapolis District reported a decline in the region's mining sector, with the closing of an iron ore mine due to financial difficulties and disruptions to production and shipments at other plants.

Labor Markets

Most District reports continued to indicate that labor markets were soft. In the Kansas City District, the pace of layoff announcements continued to ease, but layoffs continue at some large employers in the Dallas District and at some manufacturers in the St. Louis District. A few employers in Cleveland continued to report layoffs, but most indicated plans to augment or maintain their workforces. In the Atlanta District, firms are not yet hiring permanent employees but are leveraging existing staff by increasing hours and, or adding temporary personnel. In the New York District, a major employment agency specializing in office jobs reports a noticeable pickup in hiring since the last report.

District reports suggested little pressure on wages, although benefit costs continued to increase. In the Chicago District, contacts reported that many firms were instituting wage freezes and, or limiting or delaying merit increases. The Dallas District reported downward wage pressure in several industries, although some contacts said that the labor market had not eased sufficiently to allow the wage reductions they would desire. Service firms in the Boston and Dallas Districts report that downward pressure on fees has depressed pay rates. In the Kansas City District, wage pressures remained subdued, but some managers reported that their average wages had risen over the past year because lower-paid junior workers

were laid off. Respondents in the San Francisco District noted very limited upward pressure on wages overall. Several Districts reported a continued rise in the cost of employee health benefits, particularly insurance.

Prices

Anecdotal reports suggest that price pressures are mixed, with no widespread inflationary or deflationary pressures. Lower prices were reported for crude oil, fuel, and some manufactured products. Prices also continue to be soft for many retail products. However, there were reports of rising cost pressures for tuition, state taxes, transportation, and all types of insurance. Natural gas prices rose, pushing up prices of most petrochemical products to record levels. The San Francisco District noted that depreciation of the dollar has led to higher costs for some imported raw materials and textiles.

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