



July 30, 2003

## Summary

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### Summary

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Prepared at the Federal Reserve Bank of Richmond and based on information collected before July 21, 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.

Reports from the twelve Federal Reserve districts provided additional signs that the pace of economic activity increased a notch during June and the first half of July. Only the Chicago, St. Louis, and San Francisco districts characterized economic activity as sluggish while Atlanta described conditions as mixed. Reports from the remaining districts suggested somewhat stronger growth in the weeks since the last Beige Book. Consistent with the generally more positive assessments of current economic activity, several districts noted increased optimism about economic prospects in coming months.

In particular, manufacturing activity edged higher in most districts, and Philadelphia and Richmond cited an end to the recent declines in production. The districts' reports also suggested that activity in the services and energy sectors grew somewhat faster in recent weeks. In contrast, consumer spending remained lackluster—only New York reported a noticeable improvement in retail sales. Housing sales and starts remained strong across districts, spurred by low mortgage interest rates, but commercial real estate conditions remained sluggish. Prices were generally little changed, though higher health insurance costs continued to be passed on to employees according to some districts. In agriculture, excessive rainfall delayed harvesting and damaged crops in several districts but was credited with alleviating drought conditions in other districts.

### Consumer Spending and Tourism

Retail sales were mixed across districts since the last Beige Book report. Sales improved noticeably in the New York District, while sales in the Atlanta, Kansas City, Minneapolis, and Philadelphia districts, sales posted slight to modest gains. In contrast, sales revenues were said to be flat in the San Francisco District, lackluster in the Chicago District, and below year-ago levels in the St. Louis District. Among categories, apparel sales were weak in the Boston, Cleveland, and Philadelphia districts, but were higher in the New York and Richmond districts. Richmond also reported stronger sales of home merchandise, hardware, and building supplies. In the Chicago and Philadelphia districts, customers were said to be buying less expensive brands of merchandise. Retailers in the Atlanta, Dallas, New York, and San Francisco districts cited heavy discounting and noted that retail prices remained competitive. Retail inventories in the Atlanta District were described as low and balanced, but in the Dallas and St. Louis districts, some retailers reported excess inventories.

Reports on automobile sales across the districts were mixed. Sales were flat to lower in the Chicago, Cleveland, Dallas, St. Louis, and San Francisco districts. Sales were steady in

Philadelphia and Richmond, but were mixed in Atlanta. In the Kansas City District, motor vehicle sales improved in areas outside of Colorado, and Minneapolis reported that automobile sales were above year-ago levels. Contacts in several districts said new vehicle inventories were above desired levels. Dealers in the Kansas City District reported record-high inventories, but they expected the inventories would be drawn down in coming weeks.

Tourism and travel reports were also mixed in June and the first half of July. In the Chicago District, hotel occupancy rates were boosted by discounts and economy packages. Boston said that international travel more than doubled compared to last year, but the report indicated that travel industry expectations were not met because activity still trailed pre-9/11 levels. Likewise, early summer travel in the Atlanta District fell short of industry expectations even though a large cruise line in South Florida reported a recent spike in bookings and projected a robust second half. Kansas City indicated that passenger traffic rose at most airports in its District and that convention business in Denver was strong.

### **Manufacturing**

Nascent signs of a recovery emerged in the manufacturing sector with 10 of the 12 district reports indicating mixed, steady or slightly improved conditions after an extended period of declines. Atlanta and St. Louis suggested continued softness in the sector, with both reports citing increasing plant closings and layoffs. Reinforcing the view of stronger conditions in manufacturing, nine of the twelve districts were optimistic about prospects for the sector over the next six months. Despite the stronger tone, prices of manufactured products remained soft.

Chicago's report noted that nationwide light vehicle production was "pretty good" through mid-July and that heavy equipment orders edged up, in part because of a weaker dollar. San Francisco reported that new orders in the information technology sector strengthened, reducing inventory levels. Suppliers to the defense and military industry in the Cleveland and Atlanta districts continued to report strong orders, while Boston and Dallas noted a pickup in demand for personal computers and computer hardware. Philadelphia added that demand increased for residential construction materials and orders rose for printing and industrial machinery components.

But weakness persisted in some segments of the manufacturing sector. Richmond and Atlanta reported that textile shipments continued to fall, Atlanta reported layoffs at an aircraft engine plant, and Boston noted weakness in the aerospace industry. Cleveland indicated that auto production fell further though the decline was smaller than in previous months. Chicago said that demand for steel remained soft and Dallas reported that energy-related manufacturing activity was softer.

On balance, capital expenditures in the manufacturing sector remained weak, although several districts reported an increase in investment planned for the future. Atlanta reported that firms remained reluctant to buy new equipment. Kansas City indicated that recent capital spending fell but that planned future investment edged up, as optimism about manufacturing prospects remained high. Boston and Dallas noted increases in capital spending for upgrades in hardware and software, while Philadelphia said that manufacturers planned to increase investment, though some firms indicated they would likely delay expansion until next year. St. Louis reported that several plants in that district have recently announced plans to expand.

### **Services**

Ten districts reported increased demand in the service sector during recent weeks. Demand

for legal services increased in the Dallas, New York, and San Francisco districts, and Philadelphia said demand for technological expertise and business consulting rose. In the San Francisco District, contacts reported stronger demand for high-tech and real estate services. Atlanta, Boston, and New York reported a pickup in the demand for finance and insurance services and the Dallas report suggested stronger corporate finance and acquisitions activity.

### **Construction and Real Estate**

Residential real estate activity remained strong in most districts in June and early July. Atlanta, Kansas City, and St. Louis said housing sales continued to rise while Boston, Cleveland, and Richmond reported that sales remained strong. Chicago indicated that overall sales activity was mixed. In contrast, Dallas indicated that the housing market remained weak. In terms of price levels, lower-priced homes continued to be the best sellers in the Boston, Dallas, and Richmond districts and sales of upper-price range homes held up in the Boston and New York districts. Richmond reported that home prices soared in Maryland in recent months and San Francisco said prices rose rapidly in Hawaii and southern California. However, home price increases moderated in the Boston and Cleveland districts. Residential building permits increased in the Cleveland, Kansas City, Minneapolis, and St. Louis districts. Kansas City said strong starts of entry-level homes offset weak starts of upper-priced homes. Atlanta, Boston, Chicago, and San Francisco reported that low mortgage interest rates continued to drive sales in their districts.

Commercial real estate conditions remained weak in most districts during June and early July. Very little new construction activity was noted—an exception was in the St. Louis District where construction activity had begun to pick up before being delayed by inclement weather. Commercial leasing activity also remained generally stagnant, although renewals and renegotiations drove some activity in the Chicago District. In contrast to the overall sluggishness, Atlanta reported small increases in leasing and net absorption. Compared with the last Beige Book reports, vacancy rates edged higher in the Kansas City, New York, and San Francisco districts and were higher compared with a year ago in the St. Louis District. Chicago and New York reported that rents moved lower, and Richmond indicated that landlord concessions had reemerged in the office and retail sectors. However, several district reports noted pockets of improvement—leasing activity was up in the Atlanta and Minneapolis districts along with a substantial decline in vacancy rates in Lower Manhattan. Looking ahead, Cleveland, Dallas, Kansas City, Richmond, and St. Louis reported that their contacts expected the excess commercial space currently on the market to be absorbed slowly.

### **Banking and Finance**

Lending activity was mixed across districts in June and early July, as solid residential mortgage demand was accompanied by weak demand for commercial loans. Most districts characterized residential mortgage demand as either increasing or continuing strong. Dallas reported a surge in mortgage lending because borrowers were anticipating rising mortgage interest rates and wanted to lock in the current low rates. Demand for commercial loans, however, was described as weak in the Atlanta, Chicago, and New York reports, and as declining in the Kansas City report. Philadelphia reported that bank lending to businesses had increased, but that the rate of growth remained slow as most business borrowers apparently saw little need to expand their operations.

Several districts reported little change in credit quality. Philadelphia said that credit quality was not currently a problem, but added that some banks believed a further deterioration in business conditions could lower the credit quality of commercial loan portfolios. Kansas

City noted that some bankers had expressed concern that declining used car prices had lowered the credit quality of their automobile loan portfolios.

### **Prices and Wages**

District reports suggested that price and wage inflation remained broadly in check, although increases were noted in the energy, transportation, and insurance industries. Atlanta reported that health care insurance premiums rose at a double-digit rate in June and early July. The rising costs of employee benefits, most notably health insurance and pensions, boosted non-wage labor costs in the Chicago, Dallas, Kansas City, and San Francisco districts. Most district reports described wage increases as minimal, and Kansas City reported that firms were providing no more than cost-of-living increases. Contacts in Dallas and Kansas City noted that rising benefit costs were being passed on to employees, and San Francisco reported that higher labor costs could restrain hiring in the near-term.

Prices charged by manufacturers were generally unchanged in Boston, Cleveland, and Kansas City, but Chicago reported some firming resulting from the weaker dollar. On the flipside, prices paid for materials by manufacturers were mixed. The Boston, Cleveland, and New York districts noted stable input prices, but moderate price hikes were reported in Dallas, Kansas City, and Richmond.

### **Agriculture and Natural Resources**

Unusually heavy thunderstorms saturated wide areas of the Richmond, Atlanta, Chicago, and Dallas districts in June and early July, damaging crops, delaying planting, and slowing harvesting activity. Atlanta reported reduced fieldwork in many areas as a result of Tropical Storm Bill. Because of the wet weather, Richmond noted that fewer acres of soybeans will be planted and that some of the wheat crop will not be harvested. Dallas said that hail damaged cotton in the Texas Panhandle and Chicago reported damage to some crops from severe storms. Despite the damage, Chicago said corn and soybeans were generally in good-to-excellent condition. By contrast, several districts noted that the abundant spring rains had beneficial effects. The rains eased drought conditions in much of the Kansas City District, returned the soil moisture to normal levels in St. Louis, and improved crop conditions in Minneapolis. Agricultural prices were mixed. The San Francisco District noted that crop and livestock prices had remained firm and that a lower exchange value of the dollar had boosted export activity. Minneapolis and Chicago, however, reported that milk prices remained soft.

Activity in the energy industry remained strong according to reports from the Minneapolis, Kansas City, Dallas, and San Francisco districts. Minneapolis indicated that oil and natural gas exploration levels increased, while Kansas City reported that energy activity was steady in June and early July after increasing markedly during the first five months of the year. Dallas added that the level of drilling activity moved to new highs but noted that the rate of increase had slowed substantially in recent weeks, as producers tried to assess the storage situation for natural gas this summer. Kansas City reported that the end of a moratorium on new coal-bed methane drilling permits in Wyoming led to predictions of increased production of natural gas in coming months.

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**Last update: July 30, 2003**