

**June 16, 2004**

Summary

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Summary

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Prepared at the Federal Reserve Bank of St. Louis and based on information collected before June 7, 2004. 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.

Reports from the Federal Reserve Banks indicate that economy activity in April and May continued to expand across the nation. Manufacturing activity continued to rise in most districts, with several districts describing the increases as broad-based. Most Federal Reserve districts reported increased demand for services. Retail sales remained even or rose in most districts. Residential real estate markets remained strong, and a few districts noted stable or improving conditions in commercial real estate markets. Bank lending activity increased in most districts. Conditions in the agricultural sector were reported as favorable, and the demand for agricultural products remained solid. Employment activity continued to improve, with hiring increasing at a faster pace in most districts; meanwhile, wages and salaries experienced little or muted upward pressures. Many Reserve Banks reported modest increases in consumer prices, but most districts noted rising prices of inputs, especially energy-related products, building materials, and steel.

Consumer Spending

The reports on overall retail sales in most Federal Reserve districts were generally positive. Sales were strong at discount and drug stores. Apparel and accessories, office supplies, food and other consumables, home products, and summer seasonal items were strong sellers in most districts. In contrast, sales of high-end electronics and appliances and specialty and gift items were soft in most districts. Districts reporting strong sales growth include New York, Philadelphia, Atlanta, and San Francisco. Minneapolis, Kansas City, Richmond, Chicago, and St. Louis reported slight to moderate increases in sales. Retailers in the Dallas district offered mixed reports of both strong and soft sales growth, while Cleveland reported sales about even with 2003 levels. Boston reported year-over-year increases, but noted that sales growth had slowed since the first months of this year. General retailers throughout the districts expressed cautious optimism about sales in the coming months. Retailers in the Boston, Philadelphia, Dallas, and San Francisco districts expressed concerns about the effects of increasing energy prices on sales.

Vehicle sales increased modestly in many districts and remained flat or slightly down in the others. San Francisco reported strong auto sales, attributing the continued strength to the availability of financing incentives. A number of districts noted that sales of light, fuel-efficient autos had increased; dealers in Philadelphia and San Francisco also noted that sales of trucks and sport utility vehicles had decreased because of rising gasoline prices. Minneapolis also reported strong sales, while dealers in Kansas City saw a modest increase; both districts noted that rising gasoline costs had not impeded sales of sport utility vehicles.

In Dallas, Philadelphia, Cleveland, Richmond, Chicago, and St. Louis auto sales were flat or slightly up from 2003 levels. Atlanta reported sales growth in April, although sales are still below 2003 levels. In Philadelphia, Chicago, St. Louis, Dallas, and San Francisco auto dealers reported inventories above desired levels.

Manufacturing and Other Business Activity

Overall manufacturing activity increased in all Federal Reserve districts in April and May. Districts noted particularly strong growth in the defense, semiconductor, food processing, paper, lumber and other building products, textiles, automotive parts, furniture, heavy and other industrial equipment, metal products, transportation equipment, packaging, and recreational equipment and parts sectors. Districts reporting declines in activity in some sectors were Boston (home goods), Philadelphia (transportation equipment and food products), Richmond (furniture), St. Louis (paper materials and textiles), and San Francisco (commercial aircraft). Boston, New York, Cleveland, Atlanta, and Chicago reported intensifying cost pressures because of rising input costs, especially for steel and related products, petrochemical products, and wood products. Chicago and Cleveland reported robust demand for steel. Chicago also reported that steel producers' orders were booked for the foreseeable future and that heavier shipping volumes were leading to a surge in truck demand.

Activity in the services sector increased in most areas throughout the districts. Demand for freight transportation services increased in the Cleveland, New York, Richmond, Atlanta, Chicago, and St. Louis districts. Rising demand for trucking services, coupled with limited capacity, led some firms to announce new hires and capital expansions. In addition, transportation firms are more readily passing on cost increases from rising fuel and healthcare coverage costs to their customers. Tourism was up in most districts, including Boston, New York, Richmond, Atlanta, St. Louis, and San Francisco, although some contacts expressed concerns that rising fuel costs will dampen summer travel. Other services sectors reporting growth were the software and information technology, financial, insurance, healthcare, and telecommunications sectors.

Real Estate and Construction

Residential real estate activity remained robust in most districts. Home sales were exceptionally strong in the Richmond district, and Kansas City had sales in April and May that were much higher than the previous year's levels. Some areas in the San Francisco district had an increase in sales at a near-record pace. Home price appreciation was steady in Philadelphia ; however, contacts remarked that homes were taking longer to sell than earlier in the year. The New York district reported that the housing market was still strong but indicated that sales were leveling off in New York City. Single-family housing permits were up in most of the St. Louis district, as well as in the Minneapolis and New York districts. One exception was the Chicago district, where permits were down. Dallas reported a large increase in home construction, leading to a rise in inventories. Kansas City reported that the high-end market was weaker than the entry-level market, and in Chicago sales of both new and existing high-end homes softened. According to contacts in the Chicago, Dallas, and Richmond districts, "fence-sitters" were jumping into the market in anticipation of a rise in mortgage rates.

Commercial real estate markets were mostly slack, although a few districts noted signs of moderate improvement. Areas with continuing high vacancy rates, slow leasing activity, and low or flat rents in April and May were downtown Boston and the St. Louis and Chicago districts. One major exception was the Washington, D.C., area of the Richmond district, where leasing activity increased substantially in recent weeks. Leasing activity improved somewhat in the Philadelphia district. Contacts in Dallas were optimistic that commercial

markets were recovering, particularly since industrial demand had increased slightly over the past six weeks. Contacts had a positive outlook for the near future in Atlanta and Kansas City, where vacancies are expected to decrease over the remainder of the year. Nonresidential construction activity was mixed. Although construction in Atlanta remained at low levels, the Minneapolis, St. Louis, and Cleveland districts reported some improvement.

Banking and Finance

In most Federal Reserve districts, lending activity increased. Only the St. Louis and Chicago districts reported that overall lending activity was flat. Atlanta, Cleveland, and San Francisco reported strong loan demand, while Philadelphia, New York, Kansas City, Dallas, and Richmond indicated a slight increase in loan demand. Mortgage loan demand remained strong in the San Francisco, Cleveland, Chicago, and Philadelphia districts, held steady in the St. Louis and Richmond districts, and fell in the New York district. The decline in refinancing activity reported in Philadelphia, New York, Chicago, San Francisco, and Richmond districts was often linked to the rise in mortgage interest rates. Only the Cleveland district reported strong refinancing. Deposits were flat in the Kansas City district, down in the Dallas district, and up in the Cleveland district. Lending standards were generally unchanged in the St. Louis, New York, and Kansas City districts; however, the Chicago district reported some lowering of standards because of competition.

Agriculture

Agricultural conditions across the nation were generally favorable. Recent rains have brought relief from drought conditions in the Minneapolis and Kansas City districts and have improved soil moisture levels in St. Louis, parts of Richmond, and Dallas, where contacts reported the most favorable levels in five years. However, heavy rains have necessitated the replanting of some acres in the St. Louis, Minneapolis, and Chicago districts. Spring planting was progressing ahead of the average pace in several districts, and demand for agricultural products remains solid. Minneapolis, Kansas City, Dallas, and San Francisco reported strong livestock prices. Dairy prices have increased in San Francisco, and Minneapolis expects record May milk prices in Wisconsin. Boosted in part by the weakened dollar, exports have increased in the Dallas and San Francisco districts. Dallas reported concerns about a possible negative impact of the preliminary World Trade Organization rulings against cotton subsidies.

Natural Resource Industries

Activity in the mining and energy sectors remains strong in the Minneapolis district, where oil and natural gas exploration and production increased slightly from mid-April. In the Kansas City district the number of active oil and gas drilling rigs rose slightly from the previous survey, but the expansion was limited by rising equipment costs and shortages of labor. Nonetheless, contacts in this district anticipate further increases in drilling, given the high energy prices. Meanwhile, the Dallas district saw little change in drilling activities, and its offshore activity remained weak. Contacts in San Francisco have experienced an increased demand for crude oil and natural gas and want to expand capacity, but are dealing with constraints in obtaining raw materials. Minneapolis reported that the iron ore shipping season was well under way.

Labor Markets, Wages, and Prices

Most districts indicated strengthening of labor markets. Boston, New York, Chicago, Minneapolis, St. Louis, Kansas City, and San Francisco reported increasing employment, plant expansions, and plant openings across several sectors, including manufacturing, construction, freight transportation services, and healthcare services. Richmond reported soft labor demand in the retail sector but stronger demand for temporary production and distribution centers, administrative, financial, and customer service workers in recent weeks. Manufacturing employment in the district continued to expand. In Atlanta, small businesses

reported rising labor demand, as did firms in the construction, services, and automotive parts manufacturing sectors; layoffs continued in the apparel and industrial chemical sectors, however. Contacts in the Dallas district reported continuing weakness in the labor market but indicated that some firms were planning to hire new employees.

District reports indicated little or muted upward pressures on wages, although the rising cost of health insurance remained a key issue. The San Francisco and Kansas City districts noted that sufficient labor availability was leading to limited wage pressures. The New York and Dallas districts reported little pressure on wages, while the Minneapolis and Boston districts saw moderate increases in wages. The New York district noted scattered reports that starting salaries were rising in some industries. In the Boston district, contacts in the retail sector expect wages to increase. Manufacturing firms kept the wage rates of new hires stable in the Cleveland district. Contacts in the San Francisco and Dallas districts noted high costs of health insurance. Contacts in the trucking and shipping sectors in the Cleveland district also expressed concerns over health insurance costs.

Consumer price increases were generally modest, but most districts reported increasing input prices, particularly of energy-related products, building materials, and steel. Retail prices in the Boston, Philadelphia, and San Francisco districts remained generally stable and increased modestly in the Kansas City and Dallas district. Merchandise is being marked down less in the Cleveland district. Meanwhile, merchants have seen increases in vendor prices in the Cleveland and Philadelphia districts. In response to higher input prices, some businesses were able to push up prices to their end consumers in the Philadelphia, Cleveland, Atlanta, Chicago, Kansas City, and Dallas districts.

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