



September 8, 2004

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Summary

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Prepared at the Federal Reserve Bank of San Francisco based on information collected before September 1, 2004. 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 Federal Reserve Banks indicated that economic activity continued to expand in late July and August, although several districts indicated that the pace had slowed since their last reports. Districts' characterizations of the rate of expansion ranged from slow (St. Louis) to solid (San Francisco), with many districts reporting modest or moderate growth.

Household spending was reported to have softened in many parts of the nation, reflecting lackluster retail sales and some cooling in new and existing home sales. Conditions in the manufacturing sector, on the other hand, improved further nationwide, especially among capital equipment and other durable goods makers. Residential construction activity remained at high levels but slowed a bit in some regions; nonresidential construction remained tepid, as did demand for commercial and industrial space. Agricultural conditions were mixed and generally tied to the weather. Demand for consumer loans softened somewhat, but several districts noted increased commercial lending. Employers in most districts continued to expand payrolls, though districts reported some unevenness across sectors. While persistently rapid increases in nonwage labor costs continued to be a concern for many employers, wage pressures remained modest. Consumer prices were generally flat or up modestly, although there were noticeable price increases for energy and some material inputs.

Consumer Spending

Consumer spending was mixed across districts and across products in late July and August, with the pace of spending slowing on balance relative to the previous survey period. Retail sales were described as solid in San Francisco, mixed in Dallas, and softer in New York, Richmond, and Chicago. Despite the recent slowing in retail sales, several Reserve Banks noted that sales were still up on a year-over-year basis. By category, a few districts singled out computers and other electronics and women's accessories and jewelry as being in particularly strong demand. Sales of back-to-school items, especially children's apparel, reportedly were disappointing for retailers in New York, Cleveland, Richmond, Chicago, and St. Louis. By contrast, Kansas City indicated that sales of these items were up solidly from previous years, and Philadelphia noted that they were in line with merchants' expectations.

With respect to autos, sluggish sales, high inventories, or both were noted by contacts in Cleveland, Richmond, Atlanta, Chicago, and Dallas. St. Louis, San Francisco, and Kansas City, on the other hand, reported improvement in motor vehicle sales. In terms of

composition, Kansas City and Dallas indicated that SUVs and light trucks did not sell as well as smaller vehicles, though the opposite was true in Atlanta and Chicago.

Business conditions in the travel and tourism sector were reported to be strong on balance in the districts of San Francisco, Kansas City, Atlanta, and New York, and in some areas of the Minneapolis and Boston Districts. Rainy weather in the Northeast and unusually cool weather in northern Minnesota damped travel to those areas. Hurricane Charley and Tropical Storm Gaston deterred travel and tourism to some coastal areas in the Richmond District. The Atlanta District noted that most central Florida tourist attractions closed for only one day because of the hurricane, and damage to the theme parks was limited.

Manufacturing and Other Business Activity

Total manufacturing activity increased throughout the country. Districts noted that manufacturers of durable goods, including many types of capital equipment, showed the largest increases. Specifically, strong demand was reported for aerospace products (Boston, Atlanta, and San Francisco), steel products (St. Louis), industrial machinery (Richmond and Chicago), and IT products (Chicago, Dallas, and San Francisco). In addition, Philadelphia noted increased demand for instruments and electrical equipment. The few indications of weakness in selected manufacturing sectors came from the St. Louis District, which reported that firms in home fixtures, furniture, and electronic cable manufacturing anticipate plant closings, and the Cleveland District, where nondurables manufacturers noted high inventories of finished-goods and flat to falling capacity utilization. Reduced demand for transportation equipment in the Philadelphia District and for apparel in the Richmond and Atlanta Districts also was reported.

The generally robust activity in manufacturing boosted demand for transportation services in many districts. Cleveland, Chicago, St. Louis, and Kansas City reported strong demand for overland shipping services, which resulted in bottlenecks in freight movement in some areas. According to the San Francisco District, high volumes of international trade kept several West Coast seaports operating at capacity, which also led to increased demand for rail services. Similarly, New York noted that volume through the Port of New York and New Jersey rose substantially in July and August.

Regarding other services, activity during the survey period was mixed. St. Louis and San Francisco noted improvement in demand for health-care services; San Francisco also reported improved demand for the services of advertising and media firms. In contrast, in the Richmond District, service firms reported generally weaker customer demand, and the New York District cited a contact who reported weakened demand in the securities industry. Boston noted deceleration in demand for software and IT services in late July and August, despite increased demand for IT hardware.

Real Estate and Construction

Home price appreciation, home sales, and residential construction activity remained at high levels in most districts, although there were numerous reports of slight cooling in market activity. Signs of moderation in the pace of home price appreciation and/or sales were reported by New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, Kansas City, and San Francisco. The Dallas report described housing markets in Texas as "lively," but noted little increase in median home prices this year.

Commercial real estate markets were little changed from the last survey period. Most districts reported stable but high vacancies and steady but low rents. That said, there were, scattered

reports of improvement. The New York District reported that the office market in Manhattan strengthened further in July and the Richmond District noted commercial leasing activity increased in the Washington, D.C., area. Also, the St. Louis District indicated slow improvement in commercial and industrial real estate markets.

Agriculture and Natural Resources

Agricultural output and conditions in late July and August varied across the nation, with weather, as usual, playing the key role. Cooler-than-normal weather in many parts of the country, most notably the agricultural regions of the St. Louis, Chicago, Kansas City, and Minneapolis Districts, slowed crop development. The Dallas, Atlanta, and Richmond Districts noted that excessive rainfall hampered crop development. The Atlanta and Richmond Districts bore the brunt of Hurricane Charley, though its damage to crops reportedly was limited to coastal areas. Atlanta reported that the USDA estimated that Hurricane Charley ruined around 20 percent of this year's citrus harvest, including about 10 percent of the orange crop.

Higher energy prices continued to encourage oil and gas extraction. Kansas City reported that the count of active oil and gas drilling rigs in the region increased slightly from the previous survey period and was up strongly from a year ago. Oil drilling activity also was reported to have increased in the Dallas District.

Financial Services and Credit

Loan demand improved on net in many districts in recent weeks, as an uptick in demand for commercial loans offset some softening in consumer loan demand. Credit quality for both loan types was steady to slightly improved. Reports indicate that demand for commercial and industrial loans increased in the New York, Richmond, Atlanta, St. Louis, and San Francisco Districts. Commercial lending was flat in Philadelphia, Chicago, Kansas City, and Dallas. Respondents in two of the districts where commercial lending was flat--Chicago and Kansas City--indicated that loan demand from businesses was restrained to some extent by the use of internal financing, as the cash flow of many businesses improved.

On the consumer side, loan demand moderated somewhat in several districts, largely due to a falloff in mortgage lending. Some districts reported continued moderate increases in consumer loans, but several noted softening demand for home purchase and refinance loans. In characterizing home loan demand, the Chicago and Kansas City Districts indicated slight increases, and Richmond reported moderate increases. Cleveland, New York, Dallas, and San Francisco all noted softening in demand for home loans, while Philadelphia described demand for such loans as mixed.

Labor Markets, Wages, and Prices

Reports from most districts suggest continued gains in jobs during the recent survey period, although with some unevenness across sectors and regions. Several districts noted a pickup in demand for temporary service workers, including those in manufacturing, and one district (Atlanta) reported an increase in the rate of conversion of temporary workers to permanent hires. District reports also mentioned increased hiring in the energy, transportation services, durable goods manufacturing, and health-care sectors. The Cleveland and San Francisco Districts reported a pickup in labor demand among banks. Hiring reportedly was more subdued among producers of nondurable goods and selected services firms. In some cases, job losses were recorded: apparel manufacturers continued to shed jobs in the Atlanta

District, and some financial and educational services providers scaled back employment in the St. Louis District.

Wage increases remained modest overall, although there were reports of upward wage pressures for selected occupations and industries. Reports indicated that wage pressures were building for skilled workers, and remaining flat for other types of workers. District reports continued to note concerns among businesses about the rising cost of health care and other employee benefits.

The reports indicated that consumer prices were generally flat or up modestly in late July and August, although they continued to cite noticeable price increases for oil, natural gas, steel, lumber, cement, concrete, and other building materials. This characterization of price developments was widespread across the districts. In addition, Cleveland and Dallas noted price increases for processed foods, and Chicago indicated that higher oil prices have driven up the cost of plastics, rubber, and other petroleum-based materials. Despite the high oil prices, however, two districts (Minneapolis and Dallas) reported that gasoline prices had increased only moderately if at all. In this regard, refiners in the Dallas District reported that the steep rise in crude oil prices relative to gasoline has squeezed margins.

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