The Federal Reserve Board

The BEIGE BOOK

October 27, 2004

Summary

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Prepared at the Federal Reserve Bank of Chicago based on information collected before October 18, 2004. This document summarizes comments received from businesses and other contacts outside the Federal Reserve System and is not a commentary on the views of Federal Reserve officials.

Reports from the twelve Federal Reserve Districts generally indicated that economic activity continued to expand in September and early October. Boston, Philadelphia, Chicago, Minneapolis, and Kansas City noted continued expansion in economic activity. Richmond and Dallas said the pace had quickened, while New York, Cleveland, and San Francisco suggested that growth had moderated somewhat. St. Louis received mixed reports on economic activity, and Atlanta cited widespread hurricane-related disruptions. Many reports suggested that higher energy costs were constraining consumer and business spending.

Reports on consumer spending in September and early October were mixed by District and spending category. In contrast, business outlays appeared to pick up in most regions, with modest increases in both capital spending and hiring. Residential real estate activity remained robust in most Districts, although it slowed in some. Nonresidential activity was still relatively weak across the nation, though there were scattered signs of improvement. Manufacturing activity increased further since the last Beige Book. Household loan demand seemed to soften somewhat, but business loan demand picked up. Businesses in most Districts continued to express concern over the rising costs of energy and other inputs, although more manufacturers and business service providers were reportedly able to pass part--if not all--of these cost increases along to their customers. However, increases in wages and retail prices generally were subdued. Fall harvests were ahead of the normal pace, and yields of corn and soybeans were expected to set records in some Districts. Energy-related activities continued to increase, despite some disruptions caused by Hurricane Ivan.

Consumer spending/tourism

Consumer spending in September and early October was mixed by region and category. Many Districts indicated that retail sales were soft during the reporting period, while others noted modest improvement. Apparel sales were mixed across the nation. Unseasonably warm temperatures were blamed for weak sales of fall merchandise in the Cleveland, Chicago, and Minneapolis Districts. Hurricanes disrupted retail activity in the Atlanta District, though they did provide a boost to sales of building materials. Most retailers appeared content with inventory levels heading into the holiday shopping season. Light vehicle sales were strong in many Districts during September, although they dropped off in early October. Boston, New York, and San Francisco reported strong tourism activity, but Atlanta said that tourism "took a substantial hit because of the hurricanes." Contacts in many Districts said that high energy costs were constraining household spending, and some said the presidential election was heightening uncertainty among consumers.

Business spending/hiring

On balance, capital spending appeared to pick up modestly. Philadelphia, Chicago, and Kansas City reported that manufacturing firms increased their capital outlays, while Cleveland and St. Louis said that spending was mixed by industry segment. Chicago added that special factors, such as expiring tax incentives and changing environmental regulations, contributed to higher capital outlays. Several Districts reported strong demand for transportation services, and shipping companies were said to be purchasing equipment to keep up with rising freight volumes. With regard to other business spending, Philadelphia noted an increase in technology spending while Chicago and San Francisco reported gains in advertising.

Hiring activity varied by region and industry, but appeared to increase modestly. Nearly half of the Districts said that demand for temporary help increased since the last Beige Book, although momentum slowed in some areas. Reports of permanent hiring became more frequent, notably in manufacturing industries. Five District reports suggested a general increase in manufacturing jobs, while none indicated an outright decline. Boston noted some "sizable increases" in retail employment, and Richmond said that a broad array of service-producing firms were adding workers. Hiring reportedly improved in financial services (New York and Minneapolis) and transportation (Dallas) as well.

Some Districts continued to report isolated shortages of workers in particular occupations such as skilled manufacturing (Boston, Chicago), truck drivers (Cleveland), and upper-level finance occupations (Minneapolis). In addition, some Districts noted signs of more broad-based firming of labor markets. New York said "there are fewer people seeking (office worker) positions;" contacts in the Richmond District suggested there were "fewer qualified candidates to fill permanent positions;" Chicago noted there were "fewer applications for open positions;" and Minneapolis indicated that "labor markets have tightened for a number of industries."

Construction/real estate

Residential construction and real estate activity was robust again in September, although it appeared to soften further from the last Beige Book. New York was the only District to report a general increase in housing market activity. Boston and Kansas City said that sales of high-end homes had softened, and Cleveland reported weakness at all price points. Home prices continued to increase at a healthy pace in most areas. However, a Realtor in Minneapolis suggested some slight price reductions, and homebuilders in the Cleveland and Dallas Districts reportedly raised incentives and/or lowered prices to spur demand.

On balance, nonresidential activity remained weak in most Districts, but there were scattered signs of improvement. Chicago and Dallas noted some pickup in office markets, and Cleveland reported particular strength in the light industrial segment. The Richmond and Chicago Districts said that retail real estate activity remained robust.

Manufacturing

District reports suggested that manufacturing activity expanded further from the previous Beige Book. Reports ranged from solid expansion in the Richmond, Chicago, and Kansas City Districts to decidedly mixed in St. Louis. Hurricanes caused some production disruptions in the Atlanta and Dallas Districts. Stronger activity was evident across a wide array of industry segments, though, on balance, producers of durable goods exhibited more strength than producers of nondurable goods. A number of Districts reported continued strength in metals production, Richmond and Dallas noted improvements in petroleum-based products (such as plastics and petrochemicals), and Chicago said that demand for heavy equipment was still very strong. Demand for high-tech goods was mixed. Boston and San Francisco noted some softening in their semiconductor industries, but Dallas said that strong orders for consumer electronics helped boost demand for semiconductors. The September surge in light vehicle sales helped bring bloated inventories down to more desirable levels. Still, Cleveland pointed out that domestic automakers had announced production cuts.

Banking/finance

Loan demand followed a pattern similar to that reported in the last Beige Book; the household sector softened a bit while loan demand from businesses strengthened somewhat. The moderation on the household side largely reflected a decline in mortgage applications. While new originations were holding up in most Districts, refinancing activity fell off. There were no changes reported in standards and terms for household loans, and credit quality continued to improve. Many Districts indicated that business borrowing had increased; New York was the only District to note a slowdown in business lending and tighter standards on business loans. In general, business loan quality remained high and even improved in the Cleveland and Chicago Districts.

Prices/employment costs

Wage pressures generally remained stable, according to most District reports. Contacts in the Chicago District, however, said that wages continued to trend higher and, for the first time in several years, some firms had begun paying hiring and retention bonuses again. In addition, there were scattered reports of wage increases in occupations where workers were in particularly short supply, such as truck drivers and skilled tradespeople. Kansas City noted that firms in energy drilling activities had raised wages 10 percent or more to attract entry-level workers. Contacts in much of the nation continued to express concern about high benefits costs, most notably for health insurance.

Firms across the nation also expressed concern about higher input costs, particularly for energy and petroleum-based products, metals, and construction materials. Three broad industry categories were disproportionately affected by these increases: transportation, manufacturing, and construction. Six of the twelve District reports suggested that trucking firms were able to pass along most, if not all, of the cost increases to their customers. In contrast, Atlanta said that trucking firms were having a more difficult time increasing rates, and Chicago and Dallas indicated that competitive pressures were preventing airlines from passing along higher jet fuel costs. Manufacturers said that prices remained elevated for some other inputs, such as metals and plastics. While some Districts said that manufacturing firms had little success in passing along higher materials costs, one-third noted that more of their producers' customers were accepting price increases. Prices continued to rise for building materials in short supply, such as metals, concrete, and lumber. Here again, many builders had to absorb the higher input costs, but builders in the Cleveland and Kansas City Districts were able to pass along at least some of these increases to homebuyers.

Despite mounting cost pressures, most District reports suggested that retail price increases were still largely subdued. Boston was the only District to indicate that retailers were able to raise prices to the consumer in response to higher costs.

Agriculture/natural resources

Fall harvests were ahead of the normal pace in much of the country, as growing conditions improved in September and early October. Corn and soybean yields were expected to set records in some Districts. With lower current prices for corn and soybeans, more producers planned to store crops in hope of higher prices in the future. There were reports of storage and transportation constraints for corn. A record cotton harvest was expected in Texas, but both cotton and citrus crops in the Southeast experienced significant damage as a result of the hurricanes. Demand for livestock remained strong. Moreover, Kansas City and Dallas reported that pasture conditions had improved, and ranchers in the Dallas District suggested these conditions were "conducive for herd expansion."

Activity in the energy industry continued to increase, despite some disruptions in the Gulf of Mexico resulting from Hurricane Ivan. Minneapolis, Kansas City, and, to a lesser extent, Dallas reported increased drilling for oil and natural gas.

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