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Summary of Commentary on _____

Current Economic Conditions

by Federal Reserve District

July 2000

**SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICTS**

JULY 2000

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SUMMARY¹

The information collected for these reports suggests that economic activity in all Federal Reserve Districts continued to expand in June and July, but there were additional signs that the expansion was moderating in some sectors and the majority of Districts. Seven Districts—Atlanta, Boston, Chicago, Dallas, New York, Richmond, and San Francisco—reported slowing economic growth. Cleveland, Kansas City, Minneapolis, and Philadelphia Districts reported basically no change in the growth rates, and the St. Louis District reported accelerating economic growth.

District reports suggest consumer spending, manufacturing, and construction were slightly softer than in the last report. Easing demand appears to be restraining price increases. Energy prices remain high but may have peaked, and reports suggest that most of the indirect costs of rising energy prices have been absorbed by final goods producers for the time being. Labor markets continue to be very tight, and there are indications that the shortage of workers is limiting growth of activity in some areas. Many Districts reported wage increases and the growing use of benefits.

Consumer Spending. Reports of softness in consumer spending are more prevalent than in the last Beige Book. Most Districts reported that retail sales growth was unchanged or lower, but the Kansas City District reported a pick up in retail sales in June and July. Retailers in the Atlanta, Boston, Dallas, and New York Districts indicated that sales were below plan. Sales of apparel and seasonal items were noted as areas of weakness, while areas of strength

¹ Prepared at the Federal Reserve Bank of Dallas and based on information collected before July 31, 2000. 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.

included electronics, household goods, furniture and jewelry. Reports do not generally suggest a problem with excess inventories, although the New York District reported excess inventories of summer wear and air conditioners.

Vehicle sales slowed in the Dallas, Chicago, Cleveland, Philadelphia, Richmond, and San Francisco Districts, as well as rural parts of the Kansas City District. The Philadelphia District said dealer inventories had increased slightly. In contrast, the St. Louis District reported that auto sales had rebounded from a slow start this year.

Manufacturing. District reports from manufacturers were mixed but suggest slowing since the last Beige Book. Four Districts—Cleveland, Chicago, Dallas, and Richmond—reported that manufacturing activity fell or grew more slowly, while activity was unchanged in four Districts—Kansas City, Minneapolis, Philadelphia, and San Francisco. However, manufacturing activity grew in the Boston, New York, and St. Louis Districts. Atlanta reported mixed conditions.

Sales of construction equipment and inputs remained strong in some Districts, such as Boston and Cleveland, but slowed in other Districts. Demand has softened for some durable goods, such as heavy equipment, agricultural equipment, lumber, and metals. Paper producers in the Dallas District reported weaker demand, including a significant drop in demand for boxes and packing paper. In contrast, the San Francisco District reported strong sales of wood pulp and paper products. Semiconductors, computers, and other high-tech equipment continued to be in high demand, as were some nondurables, such as food.

Services. Demand for services remained high in the Districts reporting on that sector. Tourism was strong in the Atlanta, Minneapolis, Philadelphia, Richmond, and San Francisco Districts. Transportation firms in the Dallas, Cleveland, and San Francisco Districts also

reported strong or increased business. Contacts in both the transportation and tourism industries noted that higher fuel prices did not appear to be restraining demand. Firms employing temporary workers in the Richmond and Dallas Districts reported continued strong demand for their services. Temporary employment firms in the Dallas District said growth was restrained by their inability to hire workers.

Construction and Real Estate. Home building and real estate activity slowed in most Districts, but several noted that activity continued at high levels. Nine Districts reported slower residential construction—Atlanta, Chicago, Cleveland, Kansas City, Minneapolis, New York, Richmond, St. Louis, and San Francisco. Sales of existing homes were weaker in six Districts—Atlanta, Boston, Chicago, New York, Richmond, and St. Louis.

Commercial construction activity grew at a slower pace in Chicago and San Francisco, but continued to be brisk in the Atlanta, Cleveland, Dallas, Kansas City, Minneapolis, and Richmond Districts. Lenders in the Atlanta District are becoming more cautious and are requiring a higher level of pre-leasing. Contacts in the Dallas District complained that lenders are restraining construction funding because they fear overbuilding.

Banking and Finance. Loan demand remained strong or “solid” in most Districts, although several banks reported areas of slowing loan demand. Demand for real estate loans or mortgage refinancing slowed or fell in the Atlanta, Chicago, Cleveland, Kansas City, Philadelphia, New York, and Richmond Districts. Consumer lending was weaker or fell in the Cleveland, Kansas City, and St. Louis Districts. Growth in business loans was slower in the Philadelphia District, while the Richmond District reported fewer commercial loans in the “pipeline.”

Banks in the Kansas City, Philadelphia, and St. Louis Districts reported difficulty obtaining deposits. In the St. Louis District, the lack of deposit growth continues to be the biggest challenge facing banks, and many have turned to Federal Home Loan Banks to obtain funds to meet loan demand. The Philadelphia District reports that bankers are facing growing competition for personal accounts from brokerage firms and mutual funds.

A few banks noted an increase in concerns about credit quality. Bankers in the Kansas City, New York City, Philadelphia, and San Francisco Districts mentioned tighter credit standards. Commercial lenders in the Richmond District said they were taking a closer look at the creditworthiness of borrowers in cyclical industries. Some bankers in the Chicago District noted a slight “step back” in loan quality, although they stressed that overall loan quality remained high. The Atlanta, Dallas, and Cleveland Districts reported no change in credit quality.

The San Francisco District reports that contacts in Washington State say Internet retailers are having more difficulty accessing venture capital; it is reportedly more difficult to obtain financing for large and unproven businesses, while quality small- and medium-sized borrowers had no difficulty obtaining loans.

Agriculture and Natural Resources. Agricultural production has been mostly favorable according to the Chicago, Cleveland, Kansas City, Minneapolis, Richmond, St. Louis, and San Francisco Districts. Yields are expected to be above average in many areas. Still, agricultural conditions are uneven, and in parts of the country it has been feast or famine with rainfall. Several Districts reported areas of severe drought, while in a few other areas excess rainfall has been a problem. For many crops, the expectation of bumper yields has pushed down prices, and the Dallas and Cleveland Districts say many farmers expect low or

no profit for the year. Livestock producers are in better shape as beef and hog prices have increased while low crop prices have reduced feed costs.

Energy activity expanded in the Districts reporting on the sector. Exploration and development of oil and natural gas increased in the Atlanta, Dallas, Kansas City, and Minneapolis Districts. The Dallas District reports that natural gas is still the main driver for drilling activity in the United States, but oil-directed activity has begun to pick up for the first time since U.S. drilling activity turned around 16 months ago. Weak international drilling is putting downward pressure on pricing for some oil field products and drilling services, however. Minneapolis reported that the iron ore and platinum industries continue to operate near capacity.

Labor Markets. Nearly all Districts report that labor markets remain very tight, and the labor shortage has become more severe in the Boston and Kansas City Districts. Difficulty obtaining workers was restraining employment growth in the Atlanta, Dallas, Richmond, and St. Louis Districts.

The shortage of workers is reported across all types of industries, including manufacturing, services, transportation, construction, energy extraction, and information technology. Several Districts mentioned difficulty obtaining retail workers. A retailer in the Richmond District said it is a challenge to find reliable employees, adding that some “employees just don’t show up for work.” A Dallas District retailer said the lack of employee experience is hurting sales. A staffing service contact in the Chicago area said that meeting its customers’ needs for workers was “like torture.”

Most Districts said wages, benefits or incentives were growing and becoming more creative. Signing bonuses are becoming larger for both skilled and unskilled workers at many

firms in the St. Louis District, and some fast food chains are offering free meals, regular pay raises, paid training and profit sharing. The San Francisco District reports that there were few instances in which wage increases were outstripping productivity gains but there had been a pickup in benefit costs. A grocery store chain in the Dallas District has addressed advertisements to parents suggesting that they encourage their children to become employees because the chain offers good pay, flexible hours, and extensive benefits, including college tuition.

Prices. Manufacturers and retailers say input costs have risen, particularly for energy, transportation, and products linked to oil. The Boston, Dallas, Philadelphia, and San Francisco Districts report, however, that in most instances these price increases are not being passed along to customers, partly because of competitive pressures. The Boston District says offsetting cost savings and productivity increases are mitigating price pressures. Some companies cite examples of negotiating volume discounts with their suppliers, making expanded use of electronic purchasing, or shifting production to foreign locations. Price pressures from the energy industry appear to have pulled back some, as the Dallas District reported that the steam has generally come out of energy prices. Prices for crude oil, natural gas, and retail and wholesale gasoline peaked in June and July.

Despite some increase in input cost pressures, all Districts reporting on the retail industry said selling prices were unchanged or lower, with the exception of the Richmond District. Retailers in the New York District were surprised that shipping costs had not increased, or at least not significantly. The Chicago and New York Districts say retailers were doing more promotions and price discounting. The Chicago District noted that an increase in inventories had led the auto industry to increase incentive spending.

The Cleveland and Dallas Districts report a drop in steel prices, with the Cleveland District explaining that steel prices have fallen to their first-quarter levels; producers cite high inventories at “steel service centers.” Several Districts noted that builder’s reports of materials shortages had dissipated. The Boston and Dallas Districts report that lumber prices were lower.

A couple of Districts reported higher real estate prices, and the Atlanta District says health care insurance premiums and pharmaceutical prices continued to escalate at double-digit rates.

FIRST DISTRICT – BOSTON

Economic growth continues in the First District although, as noted in the June report, the pace of expansion appears to be slowing somewhat from earlier in the year. A majority of the New England retailers contacted in July report sales growth at or above expectations in recent months. Most manufacturers say business is strong; some are seeing rapid growth, while others report demand is holding at a high level. Labor markets remain tight. While both manufacturers and retailers say selected input costs are rising, they are passing very little on to customers, largely because of offsetting cost savings.

Retail

Retail contacts in the First District say that sales continue to grow, although they are seeing some evidence of a slowdown. Sales growth was at or above expectations in the building materials, household furniture, and office supply sectors, but below expectations for contacts selling hardware and apparel. Respondents say that inventories are at desired levels and head counts are mostly holding steady. Labor shortages have reportedly become somewhat more severe, with contacts increasingly resorting to wage increases in order to retain critical help. Wages are reported to be growing at a 4 to 5 percent rate, up from the 3 to 5 percent range reported over the past couple of years.

Most retail contacts say that they are not raising selling prices and that increases in vendor prices are only sporadic. Exceptions to generally stable prices include ongoing declines in prices of technology products and a reported 30 to 40 percent drop in lumber prices from year-earlier. All contacts say that higher fuel prices are adding to costs in the distribution chain, but that profit margins are either holding steady or rising slightly because of productivity improvements.

A majority of retail respondents plan some modest expansion of their operations over the next six months. Most contacts expect a slowdown in the rate of economic growth during the second half of calendar year 2000; one is concerned about a recession in 2001.

Manufacturing and Related Services

Most First District manufacturing contacts report that recent business is up relative to a year earlier. Some capital goods producers report very rapid growth in sales or orders as a result of rising demand for semiconductors, computer systems, transportation equipment, and medical equipment. Several note that they or their suppliers face capacity constraints for certain products. Manufacturers of automotive parts and construction-related products indicate that business remains strong, although in some cases production levels are holding steady or dipping slightly. A furniture manufacturer continues to expect double-digit revenue growth, albeit at a slightly slower rate than in the recent past. Respondents from nondurables sectors such as food and paper products mostly report that demand is steady compared to a year ago. A variety of exporters note particularly robust sales growth in Asian markets.

Most manufacturers cite examples of higher input costs--especially for energy, metals, and furniture-grade lumber--but these are said to be resulting in only selective increases in selling prices. Some companies have offset inflationary pressures by negotiating volume discounts with their suppliers, making expanded use of electronic purchasing, or shifting production to foreign locations. Others say that competitive pressures limit their ability to pass through cost increases.

Contacted manufacturers report limited hiring, except those with very rapid sales growth, new product introductions, or high turnover. Average pay increases are typically 3 to 4 percent, but higher at some companies making intensive use of high-end technical workers. In addition, some employers of lower-skilled factory workers mention that greater hiring expenses, out-of-cycle raises, and expanded shift differentials have boosted "true" wage costs 6 to 10 percent from a year ago.

In discussing future prospects, many manufacturers cite reasons that their industry or the U.S. economy will grow more slowly in the coming twelve months. Nevertheless, most are quite upbeat about their own companies' prospects, at least through the end of this year.

Insurance

Restructuring of the insurance industry continues, as acquisitions, sales of divisions, and

demutualization transform many companies. As a result, underlying trends in employment and revenue are hard to discern. Some contacts report employment reductions as operations are rationalized. Several spoke of competitive pressures on pricing.

Some contacts note difficulty filling information technology and other specialized positions, but few complain of labor market pressures. Salaries generally are increasing at an annual rate of 4 to 5 percent. Although most companies do not think demand for their services would be strongly affected by a possible slowing of economic growth, two contacts express concern regarding increased default risk on corporate bonds they hold.

Residential Real Estate

Residential real estate markets in New England remain strong. Respondents continue to complain about lack of inventory throughout the region. Most contacts report that brokers have more prospective buyers than listings to show to them. However, a prolonged period of price increases combined with high interest rates has discouraged some potential buyers. Multiple offers and bids above the list price, relatively frequent last year, have almost disappeared, indicating that demand has "cooled off somewhat" and the market has "lost its momentum."

In Massachusetts this year, the number of sales has been lower every month than in the same month in 1999. The changes have not been uniform, however: According to one contact, the number of "high-end" sales (priced over \$500,000) in the first quarter was 25 percent higher than in first quarter 1999, while the number of "low-end" sales (below \$300,000) was 12 percent lower. Partly because of the change in mix, the average price of homes sold in Massachusetts increased 18 percent from first quarter 1999 to first quarter 2000.

Prices rose more modestly in Rhode Island, Maine, and Vermont, with greater appreciation at the low end of the market than at the high end. New construction is very active in Rhode Island and Connecticut, although land is in short supply in desirable communities.

SECOND DISTRICT--NEW YORK

Growth in the Second District's economy appears to have moderated since the last report. While real estate prices and energy costs have risen sharply, inflation outside these categories remains subdued. Labor shortages appear to be driving up wages of office and construction workers; however, manufacturing and retail wage increases have been moderate. Most retailers indicate that sales were below plan in July, with unseasonably cool weather accounting for some but not all of the weakness.

Home construction activity, sales volume, and buyer traffic have slowed from their extraordinary first-quarter pace. In contrast, the shortage of office space in New York City has become increasingly acute, with demand described as "unprecedented"—Manhattan office rents jumped 15 percent during the second quarter. Regional purchasing managers report some pickup in manufacturing in July, along with a moderation in input price pressures. Finally, bankers report continued weakness in loan demand, increasingly tight credit standards and further improvement in delinquency rates.

Consumer Spending

Retailers describe consumer spending as sluggish in July, with most reporting that sales were below plan. On balance, comparable-store sales were little changed from a year ago—individual reports from the major chains range from a 3 percent decline to a 7 percent rise. Retailers attribute some, but not all, of the weakness to weather, this past July having been one of the coolest on record. Apparel sales were particularly weak, as were sales of most hot weather merchandise (swimwear, air conditioners, etc.). However, sales of home goods, as well as jewelry and cosmetics, were described as fairly strong.

Most retail contacts report excess inventories of summer wear and air conditioners, which are now being marked down aggressively; in other categories, however, inventories are said to be at satisfactory levels. In general, selling prices are fairly steady, with discounting of summer clearance

merchandise (mainly apparel) offsetting modest increases in other categories. While a few contacts note “surprisingly” little change in shipping costs, others report that they have risen recently, as previously negotiated contracts expire. In any event, because shipping represents a small fraction of total costs, this is expected to have little or no effect on selling prices.

Construction & Real Estate

Housing markets in the Second District have shown some sign of slowing since the last report, though home prices continue to rise. Based on surveys of local realtors, single-family house prices in and around New York City were up sharply from a year earlier, with gains ranging from 10 to 25 percent; similarly, according to two leading Manhattan real estate firms, apartment prices have risen by 20-30 percent. In both cases, however, unit sales were down noticeably. Anecdotally, local realtors note a distinct softening in market conditions—less traffic, homes staying on the market longer, fewer bidding wars—even after adjusting for the usual summer slowing. One contact describes Manhattan’s co-op and condo market as “less frenzied” and adds that, in contrast with 1999, this summer “actually feels like summer.” In upstate New York, home prices are little changed from a year ago, but unit sales are up moderately.

In terms of construction activity, recent trends are mixed. On a seasonally-adjusted basis, multi-family permits in New York and New Jersey rose to a new cyclical high in the second quarter—up 31 percent from comparable 1999 levels, led by sharp gains in New York City, Westchester County and metropolitan Buffalo. In contrast, single-family permits weakened noticeably in the second quarter, and were down 7 percent from a year earlier in New York State and 11 percent in New Jersey. Still, homebuilders in northern New Jersey indicate that plans for future construction remain strong, with the major constraints on the supply side (land and labor); they note that, despite any recent cooling in the market, they still cannot put up homes fast enough to meet demand.

Manhattan's office market grew increasingly tight in the second quarter, with demand described as "unprecedented". Midtown's office availability rate fell to 3.2 percent at the end of June, down from 4.9 percent three months earlier. Similarly, Downtown's rate fell to 5.4 percent from 6.9 percent. At mid-year, Manhattan office rents were up roughly 25 percent from mid-1999 levels, having surged by roughly 15 percent during the second quarter alone. Suburban markets, though considerably less frenetic, have also continued to strengthen: vacancy rates in Long Island, northern New Jersey, Westchester and Fairfield County are lower than a year ago, while rents on class A properties are up by 5-10 percent.

Other Business Activity

Labor shortages appear to be driving up wages in certain sectors. A major New York City employment agency reports that entry-level salaries for recent college grads—mostly office support staff with technical skills—are running close to 20 percent higher than last summer. A construction-industry contact reports that wages are running 5-10 percent higher than a year ago, and that the increases would be larger if not for a sizable pool of immigrant workers. However, contacts in the retail and manufacturing sectors indicate that wage increases remain moderate.

Electricity costs for residents of New York City and the Lower Hudson Valley rose sharply in July—the average customer's bill is reported to be up 40 percent from a year earlier, despite unseasonably cool weather. Most of the increase was attributed to a surge in fuel (natural gas) costs, as well as problems in bringing a major power plant on-line.

Regional purchasing managers' surveys indicate a pickup in the region's manufacturing sector in July, and some moderation in price pressures. Buffalo purchasers report that both production activity and employment continued to grow at a moderate pace in July, while new orders turned up sharply, suggesting incipient strength. Price pressures were slightly less widespread than in May and June.

Purchasing managers in the New York City area's manufacturing sector indicate that activity picked up sharply in July, after pausing in June, while those in other sectors were increasingly optimistic about both current conditions and the six-month outlook. Prices paid were little changed in June and July, after rising for most of the past year.

Manhattan hotel occupancy rates remained at an exceptional 88 percent in June, while average room rates have accelerated in recent months and are up nearly 12 percent from a year ago. Separately, Buffalo-area hotels report that occupancy rates have been running ahead of a year ago, while average room rates have risen 7 percent; bookings for July and August are also said to be looking strong.

Financial Developments

According to small to medium-sized banks in the Second District, demand for consumer loans, residential mortgages, and nonresidential mortgages fell compared with two months ago, while demand for commercial and industrial loans remained steady. Refinancing activity continued to slow, as has been the trend in the past few surveys. On the supply side, lenders continued to tighten credit standards over the last two months—10 percent report a tightening of credit standards, while none indicate an easing in standards. A large majority of bankers report higher interest rates on all categories of loans, as well as on deposits. Finally, bankers report further decreases in delinquency rates on all types of loans.

THIRD DISTRICT - PHILADELPHIA

Third District business activity was mostly steady in July. Manufacturers reported a slight increase in shipments but a level pace of new orders. Retail sales in June and July were even with the same period a year ago, but sales of motor vehicles have edged down. Although overall retail sales were weaker than expected by many of the region's merchants, tourism activity has been brisk in the District, and spending on travel and recreation activities has been high. Bank lending continued to rise, on balance, but growth in business loans has slowed and real estate lending has slipped.

Looking ahead, most of the business contacts surveyed for this report expect growth to pick up from July's pace but continue at a slower rate than in the first half of the year. Manufacturers forecast modest gains in shipments and new orders. Retailers expect sales to rise for the back-to-school shopping period. Bankers anticipate continued but slower growth in overall lending, although they expect a further decline in real estate lending.

MANUFACTURING

Manufacturing activity in the Third District was virtually flat in July. Although shipments from the region's factories rose slightly, new orders were basically unchanged. One-half of the industrial firms contacted in July reported steady order rates, and the number posting increases was offset by an almost equal number recording decreases in orders for their products. A few firms that manufacture capital equipment reported growth in orders, but declining demand was noted by firms that make products ranging from industrial materials to consumer goods. Overall, order backlogs fell among area manufacturers, and inventories also edged down.

Manufacturers continue to report rising input costs, particularly for raw materials, but only a small percentage of the firms polled in July indicated that they had raised prices for the products they make. Rising costs were noted in virtually all the major goods-producing sectors in the region, but only a few firms, primarily makers of industrial equipment, have raised prices for their own products.

The consensus among the region's manufacturers is that business will pick up modestly in the second half of the year. On balance, they forecast increases in orders and shipments, but they expect steady order backlogs and decreasing delivery times. Surveyed firms anticipate the upward trend in input costs will persist, but the number of firms that plan to raise the prices of their own products remains small.

RETAIL

Third District retail sales during June and July varied among the stores contacted for this report. On balance, sales for the two months were about the same as a year ago. Jewelry stores and sporting goods retailers noted fairly strong gains, as did a few clothing specialty stores. But other types of specialty stores reported lower sales compared with a year ago, and apparel sales were not strong at department stores. Department stores also indicated that overall sales were about flat compared with last year. Retailers began clearance sales in July to move out summer merchandise, and this gave a slight boost to sales. The clearance sales also helped bring inventories to appropriate levels, according to most of the store executives polled in July. Although sales are expected to be seasonally slow in August, some stores have already begun to promote back-to-school merchandise, and these stores reported good results. Merchants believe consumer confidence remains high, and they expect a pickup in sales as the fall selling season approaches.

Sales of automobiles and light trucks slowed in July, according to dealers in the region. Dealers said their inventories have increased, but they are not much above desired levels. Manufacturers continue to offer extensive rebates and incentive financing.

TOURISM

Tourism officials around the region report very high levels of tourist, lodging, and recreational activity. Hotels and campgrounds have been at full occupancy in ocean beach resorts and mountain recreation areas, and some seashore resorts have posted records for daily visitation. Amusement and theme parks also report high attendance. Business has been above expectations at restaurants and stores in resort areas. Contacts indicated that increased gasoline prices do not appear to have reduced auto travel within

the region. Besides travel to traditional vacation areas, travel to less well known areas has increased this year, according to tourism officials, as a result of stepped-up promotional activity and increased popularity of more strenuous vacation activities such as cycling and hiking.

FINANCE

Total loan volume at Third District banks was growing moderately in July, although real estate-related lending and some types of personal loans showed signs of easing. Bankers reported growth in commercial and industrial lending and credit card loans but generally indicated that other types of consumer installment lending were flat. Some of the weakness in bank consumer lending was attributed to competition from automobile finance companies. Some banks also noted recent dips in home equity lending and residential mortgage activity.

Concern for credit quality appears to be growing. Several bank credit officers noted that the percentage of borrowers that were slow in making loan payments has increased among both consumers and businesses. Additionally, some bankers said that their business borrowers were falling further behind their revenue and profit goals. These shortfalls may lead to credit reviews.

Several banks indicated that deposit growth has failed to meet their plans for the year. Some banks said that even with slowing growth in loans, they still have had difficulty obtaining the deposits they require to meet their needs. Bankers said they have been facing growing competition for personal deposit accounts from brokerage firms and mutual funds.

Looking ahead, bankers in the District expect slow growth in lending, overall. Although most expect economic conditions in the region to remain good, they anticipate some slowing in business expansion. They forecast an easing from the current rate of growth in business loans and a decline in commercial and residential real estate lending. They expect current trends in consumer lending to continue, with rising credit card lending but no growth in other types of consumer loans.

FOURTH DISTRICT - CLEVELAND**General Business Conditions and Labor Markets**

Growth in economic activity in the Fourth District is moderately strong. Labor markets remain tight in some highly skilled occupations, although residential construction is experiencing layoffs. The price of steel is declining, and other non-energy producer prices are steady. Export markets for District manufactured goods are expanding, especially in Asia.

Demand for temporary workers has eased from the high levels of last quarter, consistent with a typical seasonal slowdown. Demand decreased most for manufacturing positions but increased slightly for clerical workers. The overall supply of workers has increased due to the seasonal availability of students. Agencies currently see no need to increase wages. Increasingly, firms are hiring higher-skilled workers from the temporary agencies in hopes of finding permanent employees. All contacts expect demand for labor to increase steadily through the end of the year, with the market becoming especially tight when college students return to school in the fall.

In contrast, contacts within the retail sector continue to experience difficulty in finding qualified employees, especially in middle management. Manufacturers in the District report difficulty in finding skilled employees, especially in information technology. The rate of union wage growth is slightly higher than it was at this time last year.

Construction

Commercial builders report that construction throughout the District remains brisk. In Pittsburgh, demand is reportedly strong in all segments of commercial building, as it is in Columbus and Cincinnati. In Columbus, there has been an especially strong demand for the reclamation and retrofitting of older, vacant downtown office buildings. In Cleveland, however, the pace of building activity has moderated. One Cleveland contact cited labor shortages as a possible cause.

District home builders report a slowing in the pace of demand—one builder noted a year-over-year decline in sales of 14% for the second quarter. Builders expect lower

sales activity to persist for the foreseeable future. Declining prices for homes have cut into builders' profits.

Prices for materials remain generally flat. Bricks remain in short supply in the region. Labor market conditions in commercial construction remain tight; however, several residential construction firms reported laying off substantial proportions of their workforces—in some cases, as much as 20 percent to 30 percent.

Industrial Activity

The overall demand for steel has moderated and prices have fallen back to their first-quarter levels. Most producers report a drop in orders for the third quarter. Producers cite high inventories at “steel service centers” (middlemen in steel distribution) as the reason for the decline. Service centers had dramatically increased inventory early in the year as a hedge against expected second-quarter price increases. They are expected to sell off their extra inventory, prompting demand to pick up by the end of the fourth quarter.

Heavy-truck manufacturers report a slight increase in orders, but unless orders increase dramatically, industry sources anticipate layoffs due to the rapid diminishment of unfilled order backlogs. Construction equipment orders remain strong, especially in highway and residential construction. Durable goods production is described as good, with strong export markets. Orders for semiconductor manufacturing equipment continue to grow at very high rates. Manufacturers report that export markets in Asia are experiencing strong growth.

Despite higher fuel prices, transportation and shipping companies across the District report increased business relative to a year ago. One contact reported a 7 to 8 percent year-over-year increase in volume in the second quarter of 2000. Some firms report that they have passed some of the increases on to their customers as temporary fuel surcharges. As in other sectors of the economy, firms involved in transportation and shipping indicate a persistent inability to secure qualified workers. One contractor told of being understaffed for the last five years.

Consumer Spending

The strong retail sales growth of the first quarter has moderated, with contacts reporting steady—but not rising—sales in June and July, although year-over-year sales

have still shown an increase. Some contacts reported operating successfully with new policies that allow lower inventories. Sales of men's and professional attire are reportedly down from last year; one contact cited the recent trend towards business casual dress as a reason. However, sales of children's and women's attire are described as strong. All contacts expect sales to strengthen over the next two months more substantially than is typical for the season.

Automobile dealers report that sales of new cars in June were even stronger than last year's record volume. July was slower, however, when compared to June or to the record sales of July 1999. Dealers attributed the softer July sales to three factors: higher interest rates, higher gasoline prices, and higher lease prices. They also report steady used car sales. Some dealers said that customers are opting for used cars because of rising interest rates and lease payments. Most dealers believe that sales will be steady, only slightly off from last year's high levels.

Agriculture

With the exception of the northernmost counties of the District, production is good, and farmers are expecting above-average yields. In the north of the District, heavy rains delayed corn and soybean plantings and reduced the yield of the wheat crop harvest. Prices for soybeans, corn, and dairy products are quite low, so many farmers expect low profits for the year. Beef prices are higher than last quarter, and livestock farmers expect high production and higher profits. Across the District, farmers of most crops are delaying capital equipment and land expenditures until future market conditions become clearer.

Banking and Finance

Lending activity in the District remains strong for commercial loans, with banks reporting continued strength in auto loans this month. Both mortgage and consumer lending are weaker than last quarter. Refinancing has declined, so that banks reported overall slowing activity. They report that credit quality remains good, and their willingness to lend is unchanged. Credit standards are also unchanged.

FIFTH DISTRICT – RICHMOND

Overview: Although growth moderated from its robust pace earlier in the year, economic activity in the Fifth District continued at a high level in June and July. While manufacturing shipments and new orders advanced at relatively brisk clips, both fell short of matching the pace set in the late spring. Retailers reported lower sales growth, particularly for big-ticket items, and only modest increases in customer traffic. Activity in services firms was flat. In housing, growth was slowed by higher interest rates and concerns about future economic prospects, but commercial real estate activity maintained steady growth. Employment growth continued to be modest in most sectors, with a scarcity of workers holding back hiring at some firms. Wage pressures remained moderate. Price increases were also modest except for sharply higher oil and gasoline prices.

Retail: District retailers reported that sales growth edged lower in the weeks since our last report, led by lower big-ticket sales. Contacts at department and discount stores described sales growth as slowing or, in a few instances, flat. Several automobile dealers that we spoke with said that their sales declined in July. Employment growth at District retail establishments was little changed, in part because of a shortage of qualified workers. A manager at a department store in Richmond, Va., said that finding reliable employees continued to be a challenge, adding “[Some] employees just don’t show up for work.” Wages and retail prices rose moderately in June and July.

Services: Revenues at District services businesses were generally unchanged in recent weeks, and increases reported by water utilities and tourism-related industries were primarily driven by seasonal factors. Services employment was steady in recent weeks and wage increases were moderate, although substantially higher wages were reported for engineering and information technology professionals. A contact at an engineering firm in Charlotte reported a “surge” in professional salary levels during the last year and said that his company recently had raised wages substantially to remain competitive. Overall price pressures in the services sector remained subdued.

Manufacturing: Fifth District manufacturing activity generally advanced at an upbeat pace since our last report, but a few pockets of weakness persisted. Overall manufacturing shipments and new orders grew somewhat faster in most District factories in June and July. Nevertheless, some contacts at apparel, lumber, and fabricated metals

manufacturing facilities noted that their shipments fell slightly in recent weeks.

Manufacturing wage growth picked up in July, while employment was little changed.

Manufacturers reported that the prices they received continued to rise modestly in July, and that the prices they pay for raw materials continued to increase moderately. Higher oil prices again squeezed profits for some District manufacturers; a chemical manufacturer in South Carolina, for example, noted that higher oil prices had increased raw materials prices, pushing his profits lower in the first two quarters of 2000. In addition, a manufacturer of precision instruments in Maryland reported that a shortage of electronic components used in digital telephones and pagers had lowered his profit margins.

Finance: District loan officers reported that fears of slower economic growth lowered the demand for bank loans in recent weeks. Several commercial bankers noted a drop in their “pipeline” of commercial lending, in part because of higher interest rates and heightened customer concerns regarding future business prospects. Residential mortgage lending also was affected by a sluggish housing market as well as interest rate worries. A Greenville, S.C., banker reported weaker demand for home mortgages, adding that he was not filling several vacant staff positions because he saw little indication of a pickup in lending anytime soon. Credit standards were reported to be little changed. Several commercial lenders, however, noted that they were taking a closer look at the creditworthiness of borrowers in cyclical industries.

Real Estate: Residential realtors and builders throughout the District reported generally weaker demand in June and July. A realtor in Washington, D.C., said, that compared to a year ago, June sales were flat and July sales were substantially down. Realtors in Greensboro, N.C., and eastern West Virginia attributed slower growth mainly to higher mortgage rates. A homebuilder in Charlotte, N.C., reported more difficulty securing loans because, in his opinion, banks were tightening credit standards. Another homebuilder in the Carolinas, however, said that the prospects of higher mortgage rates in coming months had boosted his current business because more customers were committing to building ahead of the anticipated higher interest costs.

In commercial markets, realtors reported continued tight supplies of Class A office space, but more abundant retail space in June and July. In the District of Columbia, speculative office buildings were generally fully leased by the time they were completed,

and rents on office space were rising--exceeding \$50 per square foot in some areas. In contrast, there was a slight decline in retail leasing activity in the District of Columbia and in the Carolinas. A Charlotte, N.C., realtor said there was now "a sense of overbuilding of retail space and apartments in the region." In Greenville, S.C., retail and office leasing activity was described as slowing, but rent levels were unaffected. In contrast, a realtor in Richmond, Va., said that the vacancy rate for retail space had declined dramatically and that he expected rents to rise during the next 6 months.

Tourism: Tourism strengthened further in recent weeks. Along the District's coast, tourism received a huge boost in June when OpSail 2000--a parade of tall ships that made stops in Hampton Roads, Va., and Baltimore, Md.--attracted over three million sightseers. In addition, hoteliers at Virginia Beach and on the Outer Banks of North Carolina reported that their Fourth of July holiday bookings were substantially higher than a year ago. In mountain areas, the manager of an upscale resort in western Virginia noted that his Fourth of July bookings increased 10 percent compared to a year ago.

Temporary Employment: Demand for temporary workers continued to be strong. Administrative workers with computer skills remained at the top of employers' wish lists, as were light industrial workers, particularly in South Carolina. Most employment agents we talked with expected a pickup in the demand for temporary workers in coming months as a greater number of new businesses were slated to open in their areas. On balance, wages for temporary employees changed little since our last report; several of our contacts, however, expected moderate wage increases in the next six months.

Agriculture: Mild temperatures and abundant rainfall created generally good growing conditions in most areas of the District in recent weeks. Corn, soybean, and tobacco crops were in good to excellent condition in Maryland, Virginia, and most of North Carolina. Corn and soybean conditions were also good in West Virginia. In contrast, the persistent rainfall has hampered hay cutting and curing in Virginia and Maryland. In South Carolina, however, drought conditions continued in some areas, with soil moisture levels rated as short or very short in over 60 percent of the state's cropland. As a result, many of the pastures and much of the corn crop in the state remained in poor condition.

SIXTH DISTRICT – ATLANTA

Summary: The pace of economic growth in the Southeast eased slightly in recent weeks, but activity remains at healthy levels and the outlook is upbeat. Comments from retailers about recent sales were more mixed than in our last report. Similarly, reports from manufacturers varied considerably across sectors. The District's single-family construction market continued to slow somewhat, while commercial activity remained robust. Summer tourism numbers have been strong across the region. Loan demand showed solid growth overall, although weakness persisted in the residential market. Labor markets remain tight in almost all areas and sectors. Prices were stable with a few exceptions. Finally, drought conditions have resulted in significant crop losses.

Consumer Spending: Sales growth in the second quarter varied greatly across stores in the region, and this trend continued into July. Most department store and mall merchants noted a slight weakening, whereas sales growth held steady at most discount department stores. Most merchants said that recent sales had merely met or fallen below their expectations. Inventories continued to be balanced. Children's apparel and electronics are selling well, and men's apparel sales remain weak. Looking forward, most retailers expect modest growth in third-quarter sales.

Construction: The District's single-family housing market continued to slow in most areas, but activity still remains at high levels. A majority of contacts reported that construction during the second quarter was slightly below last year's frantic pace but construction strengthened slightly during the early part of July. Over one-half of builders contacted said that new home sales were down compared with last June and that sales continued to soften in July. Most Realtors described sales as flat or down slightly compared with last year. Inventories of unsold homes continued to rise

in several markets, and the rate of increase in home prices slowed. Most contacts expect activity to continue to soften through the remainder of the year.

Commercial real estate markets remained robust across the Southeast. Occupancies and absorption were described as healthy. Office space remained scarce in several markets, with speculative development continuing but at a slightly slower pace than previously. Lenders are becoming more cautious and are requiring higher levels of pre-leasing. Industrial markets remained tight across most of the region as firms continue to move into the District. The overall outlook is for balanced growth through the remainder of the year, with little risk of a serious downturn.

Manufacturing: Reports from the factory sector were mixed across industries. Energy sector indicators continued to fail to show a sizable rebound, and energy extraction service companies reported only modest growth despite \$30 per barrel oil prices. Rising fuel prices and slowing orders forced production cutbacks by a Tennessee heavy truck manufacturer; further layoffs are expected. Nissan Motor Company announced a \$1 billion expansion at its vehicle assembly plant and engine factory in Tennessee. The U.S. Air Force ordered its first Alabama-built Boeing Delta IV rocket from the new \$400 million plant in Decatur. A Tennessee-based apparel manufacturer will shut down a plant later this summer because of the inability to attract enough workers. Water shortages and high electricity prices resulting from the drought have reportedly slowed operations at some plants in Georgia.

Tourism and Business Travel: The tourism and hospitality sector continued to post solid numbers. South Florida summer bookings were the same or better than last year, and year-to-date tourist tax collections were up by double digits. Fuel price increases have not led to vacation cancellations. Atlanta convention and visitor numbers broke a record in July, sending occupancy

rates soaring. Hotel tax collections increased for four consecutive months in Nashville for the first time since 1997. Tourism remained strong along the Mississippi Gulf Coast. Potential hotel overbuilding in Orlando has become a concern.

Financial: Bankers reported that continued solid overall loan growth has compensated for soft demand in the real estate sector. Both consumer and commercial loan demand remained robust. Real estate-secured consumer loan portfolios continued to expand despite flat mortgage demand. District credit quality remained healthy, with few reports of rising levels of non-performing assets.

Wages and Prices: Labor markets remained taut, and signs of easing were scarce. Although some contacts noted that construction workers have become more available in recent weeks, a large Louisiana commercial construction firm expects its labor pool to shrink further in the fourth quarter because of new contracts. Several Florida contacts said that expansion plans have been put on hold because of shortages of essential personnel. Job markets remained tight in Tennessee, particularly for manufacturing. Every hotel in Atlanta was reported as short staffed. Employers continued to offer incentives to attract and retain workers and have increased their usage of temporary agencies and the Internet to find potential employees.

Prices remained stable, with the usual exceptions. Most contacts reported that price increases have been minor outside of energy and healthcare; however, prices are rising for products linked to oil, such as plastics and resin. Shipping costs have been increasing as firms pass on higher fuel prices. Health care insurance premiums and pharmaceutical prices continued to escalate at double-digit rates.

Agriculture: The drought continued to take a tremendous toll on the District's agricultural production. All of Georgia and parts of Florida have been declared federal agricultural disaster

areas, making farmers eligible for low-interest federal government loans. Drought-related losses in Florida are currently estimated at \$315 million. An estimated 10 percent of Georgia's cotton crop has already been lost to the dry weather, and pecan production in Georgia may be as much as 50 percent below normal. Corn and peanut crops are also in trouble. Costs increased for District farmers with irrigated land, and prices and export demand remained weak for almost all crops.

SEVENTH DISTRICT—CHICAGO

Summary. There were some further signs that the economic expansion was slowing in the Seventh District, but overall activity remained strong in June and July. Consumer spending moderated further as higher interest rates and mild summer weather hampered sales of some durable goods. Both new and existing home sales were down from last year's torrid pace, but remained strong. Manufacturing activity slowed, even as the auto industry remained on a record sales pace. Loan demand remained strong from both consumers and businesses, and overall loan quality was very good. Employers continued to struggle with labor shortages, although some reported better success in finding workers. Field crop prices continued to decline as favorable conditions in most areas increased prospects for good-to-excellent corn and soybean harvests.

Consumer spending. Consumer spending appeared to moderate in recent weeks. Retailers reported low-to-middle single-digit sales increases from the same period last year, with nondurable goods selling slightly better than durable goods. Some merchants suggested that sales of seasonal items, such as fans and air conditioners, were slow due to mild summer weather. Contacts generally described inventory levels as satisfactory, although one national chain reported that inventories were building in their Midwest stores. Some retailers indicated that promotions and price discounting were more significant this summer. Light vehicle sales in the Midwest were reportedly flat to down from a year earlier. One auto dealer reported that incentive activity shifted towards rebates and away from leasing and financing. Dealers also reported a slowdown in service activity, which one attributed to a newer and higher quality fleet of vehicles. Sales increases at Midwest casual dining restaurants slowed in July according to an industry contact, from 10 percent to 5 percent, largely the result of temperate weather. A Northern Michigan retailer reported that tourism activity in the area remained strong, but noted that vacationers were "not spending as much" as they had in previous years. There were no new reports of intensifying pressure on prices at the retail level.

Construction/real estate. Overall construction activity was again strong in June and July, despite higher interest rates than last year. Contacts reported that commercial construction activity was strong, but growth was slower. One contact noted renewed strength in light industrial development in central Indiana. A few contacts noted that some slack was apparent in developed retail space and another noted an increase in vacancy rates of class B and C office

space in a few metro areas. Home sales, both new and existing, were off from last year's exceptionally high levels, but remained very resilient in the face of higher mortgage interest rates. One realtor reported that home sales in June were down nearly 10 percent from the same month last year, yet were still the second best June results ever. Contacts suggested that the first-time buyer segment was soft, while upper-end homes continued to sell very well. Both builders and realtors noted that higher interest rates had a much larger impact on buyers at the lower end of the market. Materials shortages were virtually non-existent while most builders continued to report severe worker shortages.

Manufacturing. Manufacturing activity slowed somewhat recently, as higher interest rates dampened demand for some durable goods. The region's auto industry remained its star performer as national light vehicle sales continued on a record year-to-date sales pace through July, though unit sales had slowed from the beginning of the year. Incentive spending was still high as manufacturers reported an increase in inventories for some products. Steel production remained strong, despite a pause in June as factories performed maintenance. Posted prices for steel moved up, but actual transaction prices declined on renewed competition from imports; scrap prices were generally lower. Sales and production of heavy equipment continued to slow. One contact suggested that demand for construction equipment softened due to higher interest rates. Machine-tool makers also cited higher interest rates as contributing to slower growth. Prices for agricultural equipment "firmed," though demand remained soft, while there was "deep" discounting on construction equipment. Heavy truck sales and build rates fell, with a sharp decrease in orders and backlogs for trailers. An industry analyst noted that this was surprising given the severe shortage of drivers, which normally increases demand for trailers. Gypsum wallboard shipments decreased about 2 percent for the first half of 2000, and prices fell 9 percent from the first quarter to the second.

Banking/finance. Lending activity was generally described as strong, although growth appeared to slow somewhat. Virtually every contact indicated that commercial and industrial lending activity remained very strong, with little change in momentum. One contact did note a slight slowing in commercial real estate lending activity. While a few contacts indicated a slight increase in non-performing loans, the level was still well within an acceptable range and overall portfolio quality remained very high. A contact at one large institution noted more conservative pricing of loans, but that their customers "didn't seem to mind." Overall, however, competition

and higher interest rates continued to put pressure on margins. Some agricultural lenders were concerned that low corn, soybean, and milk prices were negatively affecting some farmers' balance sheets. Most contacts indicated that home mortgage lending activity was slower than in the same period last year, but stronger than they expected given higher interest rates. One lender noted a slight shift in borrowers' preference back to fixed-rate mortgages in recent months as these rates have come down from earlier in the year. A few contacts noted that consumers were starting to run up balances on their credit cards. Some bankers noted a slight "step back" in loan quality, but stressed that overall loan quality remained high.

Labor markets. Labor markets in the Seventh District remained very tight, although some contacts noted a slight easing. Most contacts indicated that worker shortages remained severe. Contacts in the construction and retail sectors suggested finding and retaining workers remained difficult, and a staffing service contact in the Chicago area indicated that meeting customers' needs for workers was "like torture." Some reports, however, suggested that labor market tightness may have eased somewhat. The seasonally adjusted unemployment rate for the five District states, which had been as low as 3.3 percent early in the year, had crept up to 3.6 percent in June. One temporary help agency noted that an influx of students seeking IT training and experience, up 25 percent from last year, may have helped ease shortages temporarily. A contact in casual dining, whose restaurants had been forced to cut back hours of operation due to labor shortages, reported that June was their "best hiring month in two years." There was little change in overall wage pressures noted by contacts. Most suggested that wages continued to "creep" up in recent months, although there were limited reports of more substantial wage gains. Some businesses, however, expressed concern over rapidly rising healthcare costs.

Agriculture. Crop conditions continued to improve in most areas of the District. Recent unseasonably cool temperatures were ideal for pollination/silking in the corn crop and pod-setting in soybeans. Regular rainfall during June and July relieved drought conditions in all but the westernmost portion of the District. However, improved prospects for the major field crops exerted additional downward pressure on prices in the cash and futures markets, which fell to near lows for the decade. In turn, the District's dairy, hog, and beef cattle farmers benefited from lower feed prices. Dairy farmers continued to face low product prices as milk production continued to expand year-over-year. Prices for fed beef and hogs continued at profitable levels.

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EIGHTH DISTRICT - ST. LOUIS

Summary

District economic activity not only remains strong, but has accelerated somewhat since the June report. Business contacts report increases in demand and sales in many industries. Tight labor markets continue to stymie some firms' ability to meet demand, as District states and metropolitan areas continue to post historically low unemployment rates. Labor cost increases, however, remain moderate. Home sales are down from their year-earlier levels, as higher mortgage rates keep away some potential buyers. Banks continue to experience little deposit growth, which is forcing them to seek other sources of funds for loans. Recent rains have restored topsoil moisture levels in parts of the District to adequate levels. Crops are generally in good condition.

Manufacturing and Other Business Activity

Contacts report a pick-up in demand and sales over the past two months. Automobile sales, especially of luxury models, have rebounded from a slow start this year. High gas prices reportedly have had only a marginal effect on sales of SUVs and other vehicles. Demand for nondurable goods, such as food products, is robust.

Firms continue to locate their distribution centers in the District because of its central location and its access to the hubs of the major package delivery firms. For example, in September, Wal-Mart will begin building a regional distribution center in Missouri, creating 600 jobs; two other distribution centers in Louisville, now under construction, will create several hundred jobs by year-end. A number of other companies, including several Internet companies, are also expanding and moving into the District. Three e-commerce companies, for example, have recently moved into the Louisville and Memphis regions, creating more than 1,000 jobs. Continued strength in financial markets is leading a St. Louis brokerage house to further expand its headquarters and add 550 new jobs.

A major problem for a variety of firms continues to be labor shortages, as District states

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continue to post some of the lowest unemployment rates in the country. Contacts note that starting wages for entry-level positions are, in some cases, upwards of \$8 or \$9 an hour. Signing bonuses at many firms are becoming larger for both skilled and unskilled workers. For example, UPS is offering its largest bonuses ever to package sorters who stay on the job one year, and nurses in some parts of the District are receiving \$2,000 signing bonuses. In an effort to recruit and retain new hires, some fast food chains are offering free meals, regular pay raises, paid training and profit sharing. Overall, however, labor cost increases are reportedly moderate.

Attempting to consolidate their operations, some firms have closed their less-profitable locations. A shoe manufacturer and a department store in Missouri will close a plant and an administrative office, respectively, eliminating a total of 340 jobs. District employment in both the textile and the electronic equipment industries continues to decline.

Real Estate and Construction

June home sales in the District are down from their year-earlier levels, with most real estate agents citing higher interest rates as the reason. Median prices for homes in June are generally up from a year earlier, with houses at the "lower end" (under \$125,000) reportedly selling faster than those at the "upper end" (between \$200,000 and \$350,000). Many real estate agents are seeing an increase in the inventory of available homes for sale, giving buyers a better selection in all price categories. Agents in the Louisville area, however, note that there is an excess supply of houses on the market, making for more of a buyers' market than has previously been the case.

Monthly residential building permits in June are down from May in most District metropolitan areas; year-to-date permits are down from a year earlier. Despite the slowdown, builders are still experiencing relatively strong demand for homes. Builders believe that high consumer confidence is helping to soften the effect of costlier mortgages somewhat. In the St. Louis region, however, a strike by Teamster drivers of concrete trucks that started in late June has either slowed or halted many projects, especially commercial projects. Some believe the strike could last another eight weeks.

Banking and Finance

Deposit growth, or lack thereof, continues to be the biggest challenge facing District banks. To meet loan demand, many banks, especially community banks, have been turning to the Federal Home Loan Banks to obtain funds. Without this source of funding, many bankers report, they would not be able to meet loan demand. Bankers also report that interest rate margins continue to be squeezed, as customers become more aggressive in seeking lower loan rates, while the cost of funds remains unchanged or, in many cases, increases.

According to a recent survey of large banks in the District, total loans outstanding are up almost 2 percent since late April. Both the real estate and commercial and industrial loan categories are up more than 2 percent over the period; consumer loans, though, are down almost 3 percent. Total deposits at these banks are down more than 4 percent over the same period.

Agriculture and Natural Resources

With the District winter wheat harvest now complete, early indications from the USDA are that this year's crop will be about 4 percent larger than in 1999. Arkansas, Mississippi and Missouri are posting the biggest gains. In Illinois, on the other hand, this year's crop is off by nearly 16 percent because of both a decrease in acreage harvested and a moderate decline in yields. Yields in Kentucky and Tennessee are also off from last year's levels, even though the acreage harvested is up. Contacts report that the quality of the harvested crop is good in Arkansas, Kentucky and Tennessee, but has deteriorated somewhat in Illinois and Missouri, because of sprout damage, disease and heavy rains late in the growing season.

Since the June report, rainfall in northern parts of the District has returned topsoil moisture to adequate levels; in southern parts of the District, however, the topsoil remains moderately dry. Dry weather has also affected pasture conditions in Tennessee and Mississippi, where summer pastures and grass hay fields are becoming less productive and are reportedly in poor-to-fair condition. The corn, rice, cotton and soybean crops are generally in good-to-excellent condition District-wide; however, in Arkansas and Mississippi, soybeans are in only fair-to-good condition.

NINTH DISTRICT--MINNEAPOLIS

Economic activity in the Ninth District is steady. Manufacturing, energy and platinum mining activity is at about the level last reported, while growth in consumer spending has softened. Meanwhile, summer tourism shows signs of strength, and commercial construction continues at a robust pace. In agriculture, while overall crop growing conditions are good, crop prices remain low. Labor markets are still tight as businesses continue to report wage pressures, and some price increases are noted, primarily in housing and natural gas.

Construction and Real Estate

Commercial construction remains strong. Building contracts awarded in Minnesota and the Dakotas increased 14 percent for the three-month period ending in May compared with a year earlier. A real estate firm reports that downtown Minneapolis tenants are absorbing recently built space faster than anticipated. Industrial leasing activity in the Minneapolis/St. Paul area is as strong as last year, according to an area property manager.

Homebuilding activity is slightly softer since the last report. District housing units authorized were down 6 percent for the three-month period ending in June compared with a year earlier. Nevertheless, a Minneapolis/St. Paul builders association representative foresees homebuilding finishing this year above the robust levels averaged in 1999. Demand for new apartment developments is strong in the Minneapolis area as apartment vacancy rates are below 2 percent, according to a real estate firm. Residential construction is stronger than last year in Sioux Falls, S.D., according to a chamber of commerce representative.

Manufacturing

Overall, manufacturing activity in the district is at about the level reported in June. A construction materials manufacturer, a plastic product company, a fabricated metal producer and an electroplating corporation all report sales about the same level as a year ago. A June survey reported in the St. Cloud State University *Quarterly Business Report* reveals an increase in the local manufacturing work week from March but a reduction in the number of new business start-ups. A June purchasing manager survey by Creighton University indicates a slowdown in North Dakota and Minnesota, but strong growth in South Dakota.

Mining and Energy

The iron ore and platinum industries continue to operate at near capacity. May iron ore consumption was 13 percent above year-ago levels, while May inventory levels were down 18 percent from a year earlier. A spokesperson for a major iron ore producer reports full production, but is concerned about softening demand and higher natural gas and electricity costs. In addition, mining companies are spending \$15 million to study the feasibility of a platinum, palladium, gold, copper, nickel and silver mine in northern Minnesota.

Meanwhile, district oil exploration and production continue at a strong pace in response to high petroleum prices. As a result, North Dakota mining and oil extraction taxable sales and purchases were up 45 percent in the first quarter of 2000 compared with year-earlier levels, although this represents only 0.4 percent of total North Dakota taxable sales and purchases.

Agriculture

Crops in most parts of the district show solid growth, although prices remain low. The U.S. Department of Agriculture reports corn and soybean progress ahead of the five-year average for most district states. Meanwhile crop conditions are rated good to excellent for 77 percent, 82 percent and 78 percent of the Minnesota, North Dakota and South Dakota corn crop, respectively. However, the USDA lowered its projections of 2000/2001 prices for corn, wheat and soybeans from their already depressed levels.

Meanwhile, cattle producers are gaining from strong prices and low feed costs. However, higher fuel costs and drought conditions in central Montana are tempering rancher enthusiasm. The USDA reports topsoil moisture as short or very short for 75 percent of Montana. Some central Montana ranchers are culling cows, according to a bank director.

Consumer Spending

District retail sales have softened since the last report. A major Minneapolis-based department store retailer noted that June same-store sales were down 1 percent compared with a year ago, while a major Minnesota-based electronics retailer reported that year-to-date June same-store sales in most district states were flat compared with a year ago. June mall sales in Duluth, Minn., and Fargo, N.D., were at about the same level as last year, but are down significantly in Bismarck, N.D., according to mall managers. New car and

truck registrations in South Dakota were down 8 percent in May and June compared with last year, but increased 5 percent in Montana and 14 percent in North Dakota. Retail sales are expected to increase in Minnesota as \$635 million in state surplus money was distributed to 2.4 million taxpayers in July.

Most tourism officials and businesses claim that higher gasoline prices have not hampered tourism activity. Glacier National Park has had more visitors this year than last year at this time, and Montana hotel operators expect a good season. A tourism official in the Upper Peninsula expects a 5 percent increase for the summer compared with a year ago. In contrast, hotel occupancy in South Dakota was down 3 percent for June compared with a year earlier, and visits to Mount Rushmore were off 5 percent.

Employment, Wages and Prices

Labor markets remain tight. According to a recent survey by the Minnesota Department of Economic Security, four openings exist for every 100 Minneapolis/St. Paul jobs. With the unemployment rate just over 2 percent, not all openings can be filled. In Montana, high turnover in low-skilled workers is reported. To draw applicants, a fast food restaurant is offering free meals in exchange for job applications. One sign of labor market softening was reported in the June St. Cloud State University survey, where fewer surveyed businesses expect to add workers in the next six months, almost 40 percent compared with 58 percent in March.

Employers continue to increase wages. According to an informal survey of manufacturers in the Dakotas, Minnesota and Wisconsin, about 50 percent of respondents have increased wages about 2 percent to 5 percent to retain and attract workers. Teachers in South Dakota on average received a 7 percent hike in pay compared with a year ago. Some major Minnesota law firms are paying new associates salaries 14 percent to 35 percent higher than last year.

Some price increases are noted, especially in housing and natural gas. According to an informal survey of manufacturers in the Dakotas, Minnesota and Wisconsin, about 35 percent of respondents expect to increase product prices about 2 percent to 5 percent. About 42 percent of respondents to the June St. Cloud State University survey expect to raise prices over the next six months, versus 32 percent in March. Apartment rental rates in the Minneapolis area are up over 10 percent compared with last year. Residential natural gas costs increased almost 6 percent in June compared with a year ago.

TENTH DISTRICT - KANSAS CITY

Overview. The Tenth District economy grew at a steady pace in June and July, although the residential real estate sector showed further signs of slowing. Retail sales improved, and the energy sector continued to benefit from high oil and gas prices. Moreover, manufacturing and commercial construction activity remained solid. In the farm economy, expectations of a big fall harvest kept crop prices low. Labor markets became even tighter, but wage pressures did not appear as intense. There were fewer reports of price increases for manufacturing materials than in previous surveys. Prices for construction materials rose slightly, while retail prices held steady.

Retail Sales. Retail sales improved in June and July following some sluggishness in the previous two surveys. Stores across the district also reported that sales were equal to or above year-ago levels. Sales of electronic goods were especially strong, and men's sportswear also sold well. The increase in sales was expected by most managers and served to reduce inventories to more desirable levels. Managers remained optimistic about activity heading into the back-to-school season. Most locations expected to increase inventories during the next few months. Motor vehicle sales were mixed across the district. Sales in metropolitan areas were strong, but dealers in many rural parts of the district reported declines in activity. Higher gasoline prices did not appear to affect demand for luxury cars and SUVs, which continued to sell briskly. The used car market in several large cities has also been quite strong, as expanded job opportunities and extremely low unemployment rates have increased the number of people needing cars for transportation to work. Dealers expect somewhat slower vehicle sales in coming months, due in part to consumer concerns about higher interest rates.

Manufacturing. District factory activity remained solid in June and July. A similar percentage of firms reported high levels of capacity utilization as in the previous survey. Material availability problems were generally small. Some firms, however, continued to experience difficulties obtaining steel products and electronic components and lead times for these materials edged up. A few

managers also reported a decline in service due to supplier consolidation. As a result of this consolidation, firms in some industries have banded together into purchasing associations in order to obtain better service and larger price discounts. Inventory levels fell again, due in some cases to increased reliance on Internet procurement, which allows managers to implement more of a “just-in-time” inventory system. Most managers plan to continue trimming inventories in coming months.

Real Estate and Construction. Nonresidential building activity remained solid, but housing activity continued to slow. Homebuilders reported another reduction in housing starts, with activity in some places down as much as 20 percent from last year’s record pace. The slowdown appeared to be sharpest for low-end single-family units. Construction of high-end and multifamily dwellings, on the other hand, remained strong in several parts of the district. Expectations of future residential building were rather subdued. In contrast to starts, home sales experienced a modest increase and were slightly above year-ago levels. Despite the increase in sales, inventories of unsold homes continued to rise from the low levels seen earlier in the year. Mortgage demand fell slightly, as refinancing activity has virtually come to a halt. Like builders, lenders expect flat demand for home purchases in coming months. In contrast to housing, most real estate contacts continued to report strength in the nonresidential building market, particularly for offices, hospitals, and retail space. The supply of office space, in particular, is not close to keeping up with demand in some district cities. Builders reported virtually no material availability problems.

Banking. Bankers reported that loans held steady and deposits edged down over the past month, slightly boosting loan-deposit ratios. Demand fell for consumer loans and home mortgage loans but increased for commercial real estate loans. Demand for home equity loans also rose, as mortgage refinancing remained unattractive and consumers sought to consolidate their debts. On the deposit side, NOW accounts and large CDs fell slightly, while other categories were little changed. All respondent banks left their prime lending rates unchanged during the past month, and almost all expect to hold rates

steady in the near term. Most banks held their consumer lending rates constant and anticipate no future changes. A few banks tightened lending standards, but most left their lending standards unchanged.

Energy. District energy activity continued to rise in response to high energy prices. The count of active oil and gas rigs was close to a five-year high and is expected to go higher. Both oil and gas prices have receded a bit in recent weeks but remain substantially above year-ago levels. Energy contacts expect natural gas prices to rise considerably in coming months due to supply shortages. Oil prices are expected to be steady to slightly down for the rest of the year.

Agriculture. The district's corn and soybean crops are in good condition, and a big harvest is expected if timely rainfall continues. With big crops likely, grain prices have fallen sharply and promise to remain weak. Low grain prices have pushed down feed costs for livestock producers, and strong meat demand is supporting livestock prices. As a result, most hog producers and cattle ranchers have been earning solid profits. Prices have risen more for feeder cattle than for fed cattle, however, limiting profits for feedlots. Business activity remained sluggish in many of the district's agricultural communities. Prospects of a big harvest, however, have boosted farm equipment sales in some areas.

Wages and Prices. Labor markets in the Tenth District have become even tighter since the last survey, with nearly all contacts reporting some kind of labor shortage. All types of construction workers were reported to be in short supply, in addition to entry-level retail workers, information technology specialists, and skilled factory workers. Despite the tightening in the labor market, fewer contacts reported rising wage pressures than in previous surveys. However, employers reported that benefit costs, especially for health insurance, have risen substantially this year. Price pressures for manufacturing materials lessened from previous surveys, although purchasing managers expect prices for some materials to continue edging up in coming months. Prices of construction materials rose slightly, and builders anticipate further increases. Retail prices held steady, with slight increases expected in the near future.

ELEVENTH DISTRICT—DALLAS

Overall Eleventh District economic activity showed signs of cooling in June and July. Demand for services remained strong, but manufacturing activity was weaker and retailers said sales growth was slower than expected. Construction activity continued at roughly the same pace, and bankers reported good lending growth without any reduction in loan quality. Energy activity continues to improve. Agricultural conditions are very dry, and crop producers again will have difficulty turning a profit this year despite good crop yields.

Prices. There were more reports of unchanged or declining prices than of rising prices. The steam has generally come out of energy prices. The price of West Texas Intermediate Crude has been near \$30 per barrel for the past two months, but fell close to \$28 by the end of July. Gasoline demand at the onset of the driving season was softer than some expected, perhaps reflecting some resistance to high gasoline prices by the consumer, and gasoline prices softened. Retail gasoline prices peaked nationally in mid-July, and fell every week after that. Spot wholesale prices peaked in mid-June. Spot natural gas prices fell somewhat due to cool weather in the Midwest and New England, but remained high in comparison to recent years. Natural gas inventories are still 20 percent below a year ago but have been refilled at a steady pace for the past several weeks. Petrochemical producers, who had been reporting no problems passing through much of the increase in feedstock costs due to higher oil and natural gas prices, are now reporting resistance to price increases. Metals producers said selling prices were flat or falling, even though higher energy prices have boosted freight costs. Aluminum producers expressed concern that recent investment has resulted in excess capacity and rising inventories. Aluminum prices are falling, and many firms are offering discounts to complete deals. Lumber prices were lower. By contrast, semiconductor prices have been flat or slightly up. Because chip prices typically fall, recent strength in prices has boosted profit margins of chip manufacturers, particularly for high-end memory and specialty chips. Retailers said stiff competition is keeping selling prices unchanged or declining.

Labor Markets. Contacts continued to report tight labor market conditions, with nearly all industries reporting that the difficulty hiring workers led to salary increases. A retail contact noted that

employee turnover has increased because the hot job market is giving workers more opportunities to leave, and new people are not trained properly. The contact believes the lack of employee experience is hurting sales. Real estate firms reported difficulty hiring administrative staff and front desk help and say salaries are skyrocketing. One contact tried to recruit waitresses, bank tellers or “anyone else with enthusiasm” to help run their properties. A local grocery store chain has left doorknob advertisements addressed to parents suggesting they encourage their children to become associates because the store offers free health insurance, a 401(k) plan, stock purchase plan without brokerage fees, up to \$32,000 tuition reimbursement, and “a chance to win cash and prizes.”

Manufacturing. Several manufacturers reported weaker demand, but sales remained strong for apparel, food, high-tech products and inputs to commercial construction. Energy-related manufacturing was slightly weaker. Sales remained steady “at a healthy” pace, according to electronics and computers respondents. Personal computer sales have been strong, particularly to Asia and Latin America. One contact noted that second quarter year-over-year sales were soft because last year there was a proliferation of free low-end PCs and a corporate build-up for Y2K. Demand for semiconductors also remained strong. Some fabricated metals producers reported booming demand to supply the semiconductor, telecommunications and construction industries. After a strong first half of the year, paper producers reported weaker demand for paper products, including a significant drop in demand for boxes and packing paper. Demand for lumber was down, which contacts attribute to hot weather and lower housing starts. Demand for primary metals, such as steel and aluminum, were weaker than expected, despite strong sales to mining and commercial construction. Refiners reported good demand and excellent margins since the last beige book, and they operated at very high levels of capacity. Over the last few weeks, however, their inventories have begun to grow. After reporting strong demand for petrochemicals for several months, producers are now reporting some weakness, especially for ethylene and propylene. Inventories, which had been low, have now begun to rise, which producers attribute to new capacity and a slowdown in demand. Producers of plastics are also reporting weaker demand, particularly for products used in the auto and housing industries.

Services. Demand for business services continued to be strong. Temporary firms are still reporting very strong demand, but the inability to hire workers is limiting growth. Accounting and legal firms also reported strong demand and are optimistic about the outlook. One legal contact interpreted the change in legal work as indicative of a general economic slow down—fewer mergers, acquisitions and IPOs, and more bankruptcy and insolvency cases. Demand for most transportation services has remained steady and strong.

Retail Sales. Retailers said sales growth was unchanged or slower than a few weeks ago. Many companies said this was below expectations. Most contacts did not indicate significant problems with inventories but some have reduced their purchases through the rest of the year. Auto sales have slowed slightly but remained quite strong.

Financial Services. Overall lending growth remained favorable, according to contacts, who were generally upbeat. Auto lending has been the strongest category, followed by consumer and home equity lending. Real estate lending has been the slowest growing category. Contacts said loan quality was stable, with no appreciable changes in loan loss reserves or charge-offs.

Construction and Real Estate. Homebuilders reported a pick up in sales in June and July. Contacts attributed increased traffic to a combination of continued demand from new job creation and price-cutting by builders to reduce inventory. Builders said inputs—such as wood, concrete and sheet rock—that were in short supply a few months ago are now readily available. Nonresidential construction activity also was reported as strong, although some developers say lenders are “unjustly” restraining construction because they fear overbuilding. An oversupply of apartments and office space has pushed down rental rates, but contacts remain very optimistic about future demand growth.

Energy. Domestic drilling continues to grow rapidly and faster than generally expected, and demand for oil field machinery and equipment continues to improve quickly. The U.S. rig count rose to 950 rigs in July, up from 866 in early June. Natural gas is still the main driver for drilling activity in the United States, but oil-directed activity has begun to pick up for the first time since U.S. drilling activity turned around 16 months ago. Outside North America, drilling continues to improve slowly, and activity

remains at low levels. Weak international drilling continues to put downward pressure on pricing for some oil field products and drilling services. For instance, offshore activity in the Gulf of Mexico is very strong, but excess international capacity in drilling rigs is keeping rental rates on rigs at relatively low levels.

Agriculture. Rain in June helped many areas, but high temperatures in July dried out fields and pastures and left some herds heat-stressed. Contacts say cattle prices have been high and the outlook for livestock producers is positive. Crops were mostly in good shape but some were showing signs of lack of moisture and heat stress. Production costs are again expected to exceed prices received for many crop producers, partly a result of high fuel prices but also low crop prices. Some crop producers would not have turned a profit last year without generous 1999 government payments and are looking for emergency assistance again this year.

TWELFTH DISTRICT — SAN FRANCISCO

Summary

Reports from Twelfth District contacts indicate continued solid expansion in the recent survey period, although there were signs of moderation in some sectors. District retailers reported healthy sales volumes, but slower sales growth, while service providers noted continued strong demand for most products. Manufacturing activity in the District remained solid, with many sectors posting strong growth. Conditions for District agricultural producers generally were favorable, despite increased production costs. Residential and commercial real estate activity generally remained at high levels, although the pace of growth slowed in most areas. Contacts throughout the District noted tighter credit conditions for a number of borrowers. Respondents reported that increased energy prices have begun to affect production costs. However, competitive pressure continued to hold down prices of final goods.

Wages and Prices

Labor markets remained tight throughout much of the District. Contacts noted difficulty recruiting managers, pharmacy technicians, construction tradesmen, and energy extraction workers, as well as anyone with computer or technical skills. Despite persistently tight labor markets, respondents reported few instances in which wage increases were outstripping productivity gains. However, District contacts noted a pickup in benefit costs on existing packages and increased employee demand for more comprehensive benefit schemes.

In regard to prices, increased fuel and energy prices reportedly have begun to affect production costs in a wide variety of industries. Sharp increases in electricity prices over the past several months have raised direct operating expenses for many manufacturers and retailers. Higher fuel prices have boosted shipping costs, and increased prices for petroleum-based products, such as plastic bags and containers, have raised packaging costs. However, contacts noted that, with a few exceptions, competitive pressure has prevented producers from passing

increased costs on to consumers. Although spared the indirect costs of rising energy prices, some District consumers are paying higher prices for electricity. In San Diego, for example, the retail price of electricity doubled in recent months.

Retail Trade and Services

Retailers throughout the District reported healthy, but slower, growth in sales, particularly of non-food items. Higher financing costs and increased gasoline prices reportedly tempered sales of SUVs and trucks, especially in the Intermountain states. Slower sales also were reported among apparel retailers, producing modest inventory accumulation. Advertising contacts noted a drop in demand for print advertising among retail outlets. Sales of grocery items and pharmaceuticals remained robust in recent weeks.

In the services sector, demand for District telecommunications, transportation, and tourism services remained high. Respondents reported that demand for telecommunications and Internet-related services picked up; container traffic through the Ports of Long Beach and Los Angeles remained brisk; and visitor arrivals to Hawaii from the United States accelerated during the recent survey period, increasing hotel occupancy rates and room prices.

Manufacturing

Manufacturing contacts throughout the District reported generally solid conditions. Contacts in District pharmaceutical, semiconductor, machine tool, wood pulp, and paper product industries reported strong sales. Semiconductor manufacturers described strong demand and high capacity utilization rates. Contacts noted a pickup in commercial aircraft orders from East Asia. Reports from the Intermountain states indicated that steel manufacturing has begun to stabilize from its earlier weakness; however, sales of machinery and heavy equipment have slowed, producing some inventory accumulation. In the Pacific Northwest, domestic and foreign orders for wood pulp and paper products remained brisk. In contrast, orders for lumber and structural panels have declined, and inventories reportedly are accumulating.

Agriculture and Resource-related Industries

Agricultural producers in most District states reported favourable growing conditions during the most recent survey period, except for Southern Arizona which has been suffering a drought. District beef producers reported further increases in demand and prices, and seafood producers noted strong demand and low inventories. Nut growers in California and Arizona reported increased domestic and export demand. Favorable growing conditions among fruit and vegetable producers reportedly have swelled inventories, putting downward pressure on prices. Growers throughout the District noted that increased packaging and transportation costs and higher credit costs are restraining profits.

Real Estate and Construction

Residential and commercial real estate activity generally remained at high levels, although the pace of growth slowed in most areas. Residential real estate activity slowed in the Pacific Northwest, and housing starts reportedly declined in Oregon. In Washington, residential price appreciation continued to slow, and respondents noted that homes are staying on the market longer. Similarly, contacts reported a slowing of home sales in Nevada, although home prices remained stable. In California and Arizona, home sales remained strong, and residential construction activity remained at high levels, although the timing of some sales and projects has been affected by mortgage rate fluctuations. Growth in demand for commercial properties slowed in recent weeks in many areas in the District, tempering price appreciation and easing vacancy rates. Southern California was the exception to this general trend; demand for commercial and industrial construction picked up slightly in that region, driven by growth in distribution and warehouse activity. Despite signs of slowing, construction activity remained at high levels and demand for materials and workers was robust.

Financial Institutions

District contacts reported a tightening of credit availability throughout the District. District agricultural producers, manufacturers, and builders reported increased scrutiny of loan applications. Contacts in Washington reported that Internet retailers are having more difficulty accessing venture capital. Although it is reportedly more difficult to obtain financing for large and unproven businesses, quality small and medium-sized borrowers had no difficulty obtaining loans.