

For use at 2:00 p.m., E.S.T.
Wednesday
January 17, 2001

Summary of Commentary on _____

Current Economic Conditions

by Federal Reserve District

January 2001

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

January 2001

TABLE OF CONTENTS

SUMMARY	i
First District - Boston	I-1
Second District - New York	II-1
Third District - Philadelphia	III-1
Fourth District - Cleveland	IV-1
Fifth District - Richmond	V-1
Sixth District - Atlanta	VI-1
Seventh District - Chicago	VII-1
Eighth District - St. Louis	VIII-1
Ninth District - Minneapolis	IX-1
Tenth District - Kansas City	X-1
Eleventh District - Dallas	XI-1
Twelfth District - San Francisco	XII-1

SUMMARY*

Reports from Federal Reserve Districts indicate that economic growth slowed in December, easing labor shortages somewhat and limiting price pressures for finished goods and services. Most districts reported a further deceleration in growth from the previous survey. Philadelphia reported an actual decline in activity, while Cleveland said that economic growth remained at the same slow rate as in the previous report. New York and San Francisco indicated that growth remained solid but showed some signs of softening.

Despite heavy discounting, nearly all districts reported lackluster retail sales growth during the holiday season. Automobile sales slowed substantially and most districts reported a sizable buildup of dealer stocks. All districts reported weaker manufacturing activity in December. Residential construction cooled in most districts but remained strong in New York and San Francisco. Commercial real estate activity also showed some signs of slowing. The tourism industry reported a strong start to the winter season, but other service activity weakened, particularly for trucking and other transport. Activity in the energy sector expanded as fast as drillers could find workers and rigs. Banks did not report any deterioration in credit quality but kept a watchful eye over their loans.

Labor markets eased somewhat but remained tight. Layoffs in a wide variety of industries were announced in most districts. However, business contacts expected laid-off workers to be quickly reabsorbed due to strong pent-up demand for labor at other firms. In most districts, wage pressures were similar to or slightly less intense than those in the previous survey. Prices for

* Prepared at the Federal Reserve Bank of Kansas City and based on information collected before January 10, 2001. This document summarizes comments received from businesses and other contacts outside the Federal Reserve and is not a commentary on the views of Federal Reserve officials.

most manufactured goods were flat to down despite higher costs for energy and other inputs. Consumer product prices were constrained by heavy holiday discounting.

Consumer Spending

Holiday retail sales were disappointing in nearly all districts, despite early and extensive discounting. Most districts reported that sales were up only slightly from the holiday season a year ago, when strong gains were reported. An exception was the New York district, where sales increases were on or close to plan. The overall weak sales growth led several national and regional retailers to close some or all of their stores. Many districts cited diminished consumer confidence as the biggest reason for the slower growth in activity this December. Retailers in the Richmond, Chicago, St. Louis, and Dallas districts reported that brutally cold weather further dampened sales. Winter weather items sold very well in December, as did apparel in most districts. But sales of home furnishings, fine jewelry, computers, and most other items lagged. Kansas City and San Francisco reported significant growth in online retailing during the 2000 holiday season, although the growth was below expectations in the San Francisco district. Inventory levels were reported to be satisfactory to slightly excessive in most districts. Managers seemed confident, however, that any surpluses would be trimmed during January clearance sales. Looking ahead, most store managers seemed cautiously optimistic about retail sales in the first quarter of 2001.

Automobile sales in all districts reporting on such activity were characterized as either weak or slowing. Sales of domestic cars and light trucks were reported to be especially weak in the Philadelphia and Chicago districts. St. Louis noted that used car dealerships experienced the largest decline in sales. Dealers in the Kansas City district had difficulties moving all makes and

models of motor vehicles. Inventories of unsold cars throughout the country were high, and in most districts expectations for auto sales in coming months remained subdued.

Manufacturing

Manufacturing activity weakened in all districts in December. Steel producers were reported to be in difficulty in many districts, with Cleveland and Chicago reporting a number of bankruptcy filings among steel firms. There were also announcements in several districts of temporary auto assembly plant shutdowns in the first quarter. Slower construction activity in recent months has precipitated a dropoff in production of construction-related materials and equipment in the Boston, Dallas, and San Francisco districts. On a positive note, activity at many of the nation's refineries remained solid. Production of computer-related equipment remained strong in the Boston district, but Dallas reported a sharp falloff in computer production, due to weaker consumer demand for PCs and to reductions of technology-related investment by businesses.

High input costs, the strong dollar, and weaker domestic demand were cited the most often as reasons for the slowdown in factory activity. Boston, Richmond, and St. Louis reported that higher input costs were squeezing profits for some firms. Half the districts also mentioned widespread concern among manufacturers about higher energy costs. Some fertilizer, chemical, and smelting plants in the St. Louis, Minneapolis, Kansas City and San Francisco districts have even shut down in order to resell their electricity or natural gas supplies on the open market. Philadelphia, Cleveland, Richmond, Atlanta, and Kansas City reported that heavy import competition, due largely to the strength of the dollar, was hampering manufacturing sales.

Atlanta also reported that uncertainty about the U.S. stock market was adversely affecting firms' capital expenditure plans.

Real Estate and Construction

Residential real estate activity cooled in most districts. Single-family residential construction remained strong in the New York and San Francisco districts, but it declined in the St. Louis, Kansas City, and Dallas districts and showed signs of slowing elsewhere.

Homebuilders in the Cleveland district reported that they have far fewer projects scheduled for coming months than at the same time last year. In contrast, builders in the New York district reported a persistent backlog of projects. Home sales were mixed across housing markets, with New York again reporting the most robust activity. Boston and Richmond reported that reduced consumer confidence was adversely affecting sales, with potential homebuyers showing greater willingness to delay home purchases. Unusually cold weather was also reported to have held down activity in some districts.

There were also signs of slowing in commercial real estate activity in some districts. Commercial construction slowed in the Dallas, Richmond, and Atlanta districts, and was described as mixed in the St. Louis and Cleveland districts. Commercial building remained solid in the Kansas City district. New York and Richmond reported that contraction by dot-com enterprises has helped free up some office space, although the office market in the New York district remains very tight. Shortages of office space were also reported in parts of the Richmond, St. Louis, and San Francisco districts.

Tourism and Services

Tourism was better than expected in those districts reporting activity. Unusually cold weather and a good snow base boosted visits to ski resorts in the Richmond and Minneapolis districts. Atlanta also reported that holiday travel to Florida was very strong.

Activity in other service industries was generally down. Demand for trucking services fell considerably in the New York and Cleveland districts, and was down slightly in the Dallas district. Meanwhile, trucking firms' fuel, insurance, and labor costs continued to rise, resulting in an increase in bankruptcies and truck repossessions in the New York district. St. Louis reported a slowdown in barge traffic on the Mississippi River due to low water levels. Richmond and Dallas reported that revenues fell at most business service firms. In contrast, revenues were up in the Boston district's insurance industry.

Financial Services

Bank loan growth slowed somewhat in most districts in December. Bankers in the Cleveland district said decisions by some manufacturing firms to delay investment projects had reduced demand for business loans. Atlanta and Chicago also reported some slowing in business loan demand. New York, Kansas City, and San Francisco reported somewhat weaker demand for both consumer and business loans, while Dallas reported that demand slowed for all categories except loans to energy firms. Demand for home mortgages was mixed, but lenders in several districts said they expect refinancing activity to pick up if low mortgage rates persist.

There were no new reports of decreases in credit quality, but banks generally continued to tighten credit standards and said they were keeping a watchful eye on the financial condition of their borrowers. Banks in the New York, Philadelphia, Atlanta, Chicago, and Dallas districts

reported they were continuing to tighten their credit standards. Banks in many districts also said they were monitoring credit quality carefully to detect any deterioration. Bankers in the Chicago district reported they were keeping an especially close eye on loans to retail and manufacturing sectors, while bankers in the Richmond district said they were paying special attention to loans to cyclical industries.

Natural Resources and Agriculture

The energy sector continues to expand. Despite recent easing in oil prices, contacts in the Dallas, Kansas City, and Minneapolis districts reported that oil and natural gas prices remain sufficiently high to promote continued expansion of exploration and production. However, Dallas and Kansas City reported that the pace of industry expansion is constrained by worker and equipment shortages. Given these shortages, the recent dramatic rise in natural gas prices is not expected to produce a further acceleration in drilling activity. Other extraction industries are not doing as well, as metal mining and processing activity in the Minneapolis district continued to decline in the face of falling commodity prices and high electricity costs.

In the farm economy, the onset of winter weather across the country has had mixed effects. Minneapolis reported that moisture from heavy snowfalls has benefited the winter wheat crop and is expected to reduce the likelihood of drought conditions in the coming growing season. However, severe winter weather also contributed to a worsening in pasture conditions for livestock and an increased use of alternative forages in the Richmond, Minneapolis, Kansas City, and Dallas districts. The alternative supplies seem to be generally available except for some reports of hay shortages in the Dallas district.

Labor Markets, Wages, and Prices

Labor markets eased somewhat but remained tight in most districts. Layoffs in a wide variety of industries were announced in most districts. Due to strong pent-up demand for labor at other firms, however, contacts in most districts expected laid-off workers to be quickly reabsorbed. Contacts in the Boston, New York, Atlanta, and Kansas City districts also expressed hope that recent dot-com layoffs would alleviate the severe shortage of information technology workers. Businesses that were still having difficulty finding qualified workers included retailers in the New York and Cleveland districts, construction firms in the New York and San Francisco districts, and health care firms in the Atlanta district. In contrast, service firms in the Chicago district said they were having more success in finding qualified workers in the last few weeks of the year, and firms in the St. Louis district reported that the slowdown in demand in the district was making it easier to fill vacancies.

Wage pressures in most districts either held steady or decreased slightly in response to the easing in labor markets. Chicago, Dallas, Kansas City, and San Francisco all reported some moderation in overall wage pressures. New York described wage pressures as strong but steady, while Minneapolis reported that wages continued to increase at a moderate pace. Despite the overall slowdown in economic growth, a number of districts reported strong wage pressures for certain types of workers, including information technology workers in the Boston district, retail workers in the Richmond district, construction workers in the San Francisco district, and union workers in the Cleveland district.

Price pressures for consumer goods were subdued, while prices for most manufactured goods were flat to down despite higher input costs. Extensive discounting by retailers during the holiday shopping season helped constrain consumer prices in most districts. Retail prices

increased at a slower rate in the Richmond district, held steady in the Boston district, and declined somewhat in the Kansas City and Dallas districts. Manufacturers in many districts reported that their input costs rose in December, especially for energy, but that they were unable to pass these cost increases on to customers due to intense foreign and domestic competition and slowing demand. The most notable reports of downward pressure on selling prices were for steel firms in the Cleveland and Chicago districts and for a wide variety of manufacturing firms in the Dallas district, including producers of metals, cement and concrete, paper, and lumber. In the service-producing sector, telecommunications firms in the Dallas district reported their prices were falling rapidly, but insurance firms in the Boston district said that reduced price competition had enabled them to raise premiums to more profitable levels.

I-1
FIRST DISTRICT – BOSTON

Economic growth is slowing in New England, according to Beige Book contacts. Retailers say that sales during the holiday season were generally above year-earlier levels, but that they expanded less than last year. With exceptions, manufacturers report slower growth or declines in business from year-earlier. Selling prices are said to be mostly flat. Respondents indicate that they view 2001 with caution.

Retail

Retail contacts say that sales continue to grow, but at rates slower than last year. For the October through December period, sales increases at responding firms averaged a modest 3 percent from year-earlier. Sectors reporting better than predicted sales growth were apparel and tourism. Weaker than expected results were reported in art and architectural supplies, furniture, and the discount retail sector. Newspaper reports indicate that poor holiday sales growth in the discount sector led some large regional retailers to close down operations.

Employment levels are mostly said to be holding steady. Labor shortages continue to be a problem, leading to some additional wage increases aimed at retaining critical help. Base wages are reported to be growing at a 4 to 6 percent rate. Retail contacts say they are not raising store prices and they see only sporadic increases in vendor prices. Profit margins are reported to be holding steady.

Retailers have become more cautious, with most respondents indicating that they do not intend to add new stores in 2001. Contacts remain cautiously optimistic about consumer spending and their own sales in 2001; they say they expect a slowdown in economic growth during 2001, but not a recession.

Manufacturing and Related Services

A slight majority of First District manufacturing contacts indicate that recent sales or orders are up relative to a year earlier. However, compared to the previous Beige Book, a larger share of responding firms say business is down (rather than flat). Further, among respondents reporting growth, several indicate that business has slowed recently. Most manufacturers indicate that they are cautious about prospects in 2001, with some anticipating a weak first half.

The most negative reports come from suppliers to the auto industry; in some cases, revenues are down at a double-digit rate from late 1999 or early 2000. Manufacturers of construction-related materials and equipment see some deterioration from prior trends; some believe the results reflect cold weather or construction labor shortages, while others interpret the results as evidence of a slowing economy. Makers of consumer products report, at most, modest revenue growth, and they are bracing for a deterioration as wholesale and retail business customers reduce their inventories or undergo consolidation. By contrast, contacts making products for the electric power industry, computer-related equipment, non-automotive transportation equipment, and medical equipment mostly report continued positive trends. Some firms have double-digit gains in sales or orders from a year ago for these products.

Contacts make widespread mention of higher energy costs. For many, fuel and freight bills are way up from a year ago. The costs of some petrochemicals materials such as plastics also have risen, as have costs for materials produced using energy-intensive processes (e.g., glass). Selling prices are mostly flat or rising at low single-digit rates. Contacts continue to claim savings associated with aggressive purchasing programs, long-term contracts, or productivity enhancements. However, they are making more frequent references to a squeeze on profits associated with higher input costs, plans to raise selling prices in order to recoup higher costs, or a more cautious stance with respect to capital spending in order to contain costs.

Contacts report some easing of labor market pressures either because their own labor requirements are falling or because workforce reductions at area firms (especially dot-coms) have augmented the available labor supply. Almost half the group mention cuts in temporary staffing or layoffs at their own firm. However, manufacturers continue to characterize markets for technically oriented professionals as tight, and most have seen no softening of overall wage and salary trends.

Residential Real Estate

Residential real estate markets in New England are fairly quiet. Activity has slowed in most areas, reflecting the usual seasonal pattern plus changing economic conditions. The stock market

downturn and more generally perceived economic slowdown have generated uncertainty. Anticipated declines in interest rates are said to have caused potential buyers to delay house purchases. Although Massachusetts contacts report an increase in the number of sales in October and November compared to the same period last year, contacts in other states say that potential buyers are in a “wait and see” mode. Upper-end property sales are stronger than lower-end sales; in Massachusetts, the number of sales in the \$500,000 and above range increased every quarter this year. Inventory is stable. Most contacts anticipate that activity will remain slow through the winter, but are hopeful that sales will pick up in the spring.

Insurance

Most contacts in the insurance industry report increases in sales in the last quarter of 2000. They indicate that reduced price competition has allowed them to raise some insurance rates to more profitable levels. On the down side, a couple of respondents mention that claims rose at the end of the year. Among the companies contacted, employment is generally flat. Two companies say they are moving some work to Florida or India where they face lower space and personnel costs.

Although none of the contacted companies mention new hiring initiatives, they all say that the labor market for information technology workers is very tight. Two contacts are seeing positive results from retention programs and others note reduced labor competition from the dot-com sector.

Generally, contacts are rather optimistic about 2001. They expect insurance sales to continue to increase although some express concern about the impact of stock market fluctuations on the profitability of their investment divisions.

SECOND DISTRICT--NEW YORK

Economic activity in the Second District is generally well maintained at a high level, though there have been scattered signs of softening since the last report. Input cost pressures have intensified somewhat, but prices of finished goods and services remain generally stable. Despite a number of layoff announcements, labor markets remain tight, with brisk hiring activity reported in financial and related services. Wage pressures remain strong but steady, while there are ongoing reports of large hikes in health benefit costs.

Retailers report that sales were on or close to plan in December, with same-store sales up moderately from the strong levels of a year earlier. Inventory levels were generally described as satisfactory; both prices and merchandise costs were little changed from a year ago. Real estate and construction activity remain generally robust, although Manhattan's residential and commercial real estate markets have cooled somewhat. Purchasing managers report some slowing in the manufacturing sector. The trucking industry has seen a sharp increase in bankruptcies and truck repossessions, as business has slowed while costs have risen. Finally, bankers report weaker consumer loan demand, rising consumer delinquency rates, and tighter credit standards—particularly on commercial loans.

Consumer Spending

Retail sales were on or close to plan in December. Compared to a year earlier, same-store sales at major chains ranged from modest declines to gains of close to 5 percent. Similarly, smaller retailers across New York State indicate gains of 2-4 percent. Most contacts note that weakness in the first half of the month was offset by a late surge in the days immediately before Christmas. Fairly strong sales were also reported for the week after Christmas, but a major snowstorm on December 30—the last day of the fiscal month for most chains—held down the monthly total. Sales have generally been described as brisk in early January. Strong sales were reported for apparel (especially women's apparel), but sales

of home furnishings were generally described as sluggish. Retailers report that inventories are in good shape in most categories, though some contacts report stock-outs of a wide range of winter-weather merchandise, ranging from automotive products and shovels to boots and outerwear. Almost all contacts indicate that both selling prices and merchandise costs were virtually unchanged from a year earlier. In addition, most contacts say that the degree of discounting is about the same as a year ago. While a number of retailers say that their stores were under-staffed because they were unable to hire as many workers as desired, wage pressures during this past holiday season were described as comparable to the prior year. However, some contacts report large increases in health benefits costs.

Construction and Real Estate

Despite scattered signs of cooling in the residential and commercial real estate markets, prices are still up substantially from a year ago, and construction activity remains strong. Manhattan's office market remains tight, with asking rents running 30 percent higher than a year ago; however, availability rates (space that is vacant or coming on the market over the next year) have edged up from the extraordinarily low levels seen in the third quarter. There are also reports of a sizable increase in office space available for sub-lease—largely from dot-coms—which is not included in the availability rates.

Realtors report that the market for existing single-family homes was robust in November, with prices up 10-15 percent from a year earlier across the New York City area, and up roughly 3-5 percent in upstate New York. Unit sales also picked up in November and were higher than a year earlier—both upstate and downstate. More recently, though, Manhattan's co-op and condo market has shown more signs of softening. According to a major New York City realtor, as well as a leading appraisal firm, apartment prices remained well above year-earlier levels in the fourth quarter; however, unit sales fell, properties stayed on the market for longer, and there were more price concessions and fewer bidding wars. Both buyers and sellers are said to be increasingly “nervous”, and the market is described as

much less speculative.

Residential construction activity remained strong in the fourth quarter, and a persistent backlog of orders for new homes, as well as public infrastructure projects in the pipeline, should provide strong momentum for the industry during 2001. Permits to build multi-family housing picked up in New York and, especially, in New Jersey in November. It appears that more apartment units will have been started in the District in 2000 than in any year since 1987. Single-family permits held steady in November and were little changed from a year earlier. Still, homebuilders in northern New Jersey indicate that land and labor shortages persist, that demand continues to outstrip supply, thus driving up home prices, which are running 10-15 percent higher than a year ago.

Other Business Activity

Despite a sizable number of layoff announcements at both Internet firms and Web divisions of traditional media companies, the New York City area's labor market is still described as extremely tight. A leading employment agency reports that strong pent-up demand for workers persists—particularly from the financial services and legal services industries. In addition, most workers losing their jobs at dot-coms are being snapped up by other firms. There remains particularly strong demand for legal, administrative support and computer-savvy workers.

Purchasing managers report some slowing in the region's manufacturing sector, along with a pickup in price pressures. Buffalo-area purchasers report that the local economy continued to expand at a moderate pace in December, as production activity and employment levels held steady while new orders continued to increase. However, purchasers in the New York City area report that manufacturing activity retreated in December, after expanding steadily since mid-year. They have also become less optimistic in their expectations for the business outlook—many have scaled back their hiring intentions, and a large majority of manufacturers have reduced their purchases (more than the seasonal norm).

Virtually all respondents in the New York City area note rising energy costs, while cost increases are also reported for construction and architectural services. More generally, purchasers in both areas report increasingly widespread rises in input costs.

The trucking industry is experiencing hard times, according to an industry expert. Demand for trucking services has softened considerably, while fuel, insurance and labor costs have risen significantly. Many firms have imposed fuel surcharges on customers, but these are being limited by the threat of competition from railroads. With more trucking firm bankruptcies in 2000 than in a number of years, there has been a sharp increase in truck repossessions, which has, in turn, created a glut of used trucks and a drop in prices.

Financial Developments

Demand for all types of loans fell over the last two months, according to the latest survey of small to medium-sized Second District banks. Declines were particularly widespread for consumer loans and residential mortgages, even after adjusting for seasonality. Refinancing activity also weakened. Bankers reported further tightening in credit standards—particularly on commercial loans and non-residential mortgages. Interest rates on both loans and deposits fell over the last two months. Loan performance was mixed. Delinquency rates rose for consumer loans but declined for non-residential mortgages; they were essentially unchanged in other categories.

THIRD DISTRICT – PHILADELPHIA

There were signs of slower business activity in the Third District in December compared with November. Manufacturing production appeared to ease, although shipments remained steady. Retailers made scant gains in the Christmas shopping period compared with the previous year. Auto sales slipped in December for the second month in a row. Total bank lending increased slightly, largely because of growth in consumer lending.

The consensus among the business firms contacted for this report is that economic activity will be essentially flat in the quarters ahead, although some contacts expect slow growth for their businesses. Manufacturers expect only steady conditions during the first half of the year. Retailers anticipate a slight gain in sales during the next few months but continued pressure on profit margins. Auto dealers expect sales to run at steady pace in 2001, but to be below last year's rate. Bankers forecast little if any gains in lending through the first half of this year. Despite the current slowdown in growth and subdued prospects for the year ahead, firms in a range of industry sectors continue to report that they are having difficulty finding qualified workers at all skill levels.

MANUFACTURING

Conditions in the Third District manufacturing sector were virtually flat in December, although there were some indications that production was slipping. New orders and shipments were steady, but employment and working hours slipped. Order backlogs declined as well. There was little variation in business conditions across the range of goods-producing industries in the region. However, makers of industrial materials and equipment seemed to be facing a weaker situation. Several firms in these sectors reported that the high value of the dollar in relation to foreign currencies was hampering their exports and aiding foreign producers in competition for domestic markets.

Manufacturers expect basically steady activity in the first half of the year, on balance. While some forecast gains in orders and shipments, others expect demand for their products to weaken further before rebounding. Producers of industrial and business equipment, in particular, say sales may not increase until well into the year. Despite the lackluster outlook, capital spending plans among area manufacturers remain fairly robust. Over one-third of the firms contacted for this report have scheduled higher outlays for new equipment and expanded facilities in the first half of the year, and only about one in ten have trimmed capital spending budgets.

Manufacturers indicated that input costs continued to rise at the turn of the year, but reports of price increases appear to be less widespread than they were through much of 2000. Comments from firms in the region suggest that the costs of some agricultural products and basic materials have risen recently, but overall, industrial prices have been steady. Higher energy costs, however, continue to be a concern for manufacturers as well as other businesses in the region. Despite the rising cost of energy and a few other inputs, most firms have not raised prices for the products they make.

RETAIL

Retail sales in the Third District during the holiday shopping period fell below most retailers' expectations, and year-over-year gains were minimal, on balance. Sales of apparel and jewelry were particularly weak, although merchants said sales in nearly all merchandise lines were less than they had anticipated. Store officials attribute the poor performance to the absence of new products this year and a recent retrenchment in consumer confidence. Discounting was extensive, and store executives said profit margins fell. Inventories in early January were above plan for most of the retailers contacted for this report, although the extent of excess merchandise did not appear to be great. Merchants expect that most of the overhang will be reduced through clearance sales in January. The balance of opinion among the store executives surveyed in January is that sales will be steady to slightly up during the first quarter.

Auto dealers reported that sales of new and used autos and light trucks fell in December. Most of the drop in new-car sales was the result of falling demand for vehicles produced by U.S. companies. Sales generally rose for imported vehicles and

those made in the U.S. by foreign-based manufacturers. Overall, dealers in the region indicated that their inventories were above desired levels. Dealers believe that the fall in demand for cars and trucks can be attributed to buyers' waning interest in the models produced by domestic manufacturers as well as a recent slip in consumer confidence. Dealers in the region expect sales in 2001 to be about 5 to 10 percent below the rate set in 2000.

FINANCE

Total loan volume outstanding at Third District banks has been edging up recently. Consumer lending has risen, although bankers indicated that much of the gain has been seasonal. Real estate loan volumes have increased at many banks in the District for both residential and commercial properties. Business lending has varied. Some banks have posted modest gains in loans to businesses, but there have been nearly equal numbers of banks that have had decreases or merely steady business loans outstanding.

Bankers in the Third District expect overall loan volumes to be flat or grow slowly this year. Several bankers noted that commercial loan standards and interest rates have firmed recently, and they expect fewer potential business borrowers to qualify for credit in the next quarter or two than would have last year. Some bankers also noted recent declines in profitability among their current commercial customers, which could lead to reductions in the amount of credit extended to these firms. Bankers generally expect real estate lending to ease, although they anticipate an increase in residential mortgage refinancing activity if recent declines in mortgage interest rates persist.

FOURTH DISTRICT - CLEVELAND

General Business Conditions

Growth in economic activity in the Fourth District remained at the same slow rate described in our last report. The steel industry in particular continues to show a great deal of strain as a result of strong foreign competition and weaker domestic demand. Retail stores experienced a slower-than-expected holiday season, as consumer spending remained soft. However, labor markets have remained fairly buoyant, although less so than they had been earlier in the year.

Industrial Activity

The steel industry is facing some tough times. Mills are operating 10 to 30 percent below capacity, domestic demand has slowed, and there is intense competition from foreign producers, in part due to the strong dollar. Several firms have filed for chapter 11, and more filings are expected. January orders are a little stronger than December's, but first-quarter orders are expected to be weak. Producers of specialty steel are in a better position. While prices on specialty steel products decreased along with carbon steel, orders for specialty steel remain stronger.

Consumer Spending

Retail stores reported disappointing sales during the entire holiday season, with the lackluster performance extending across all categories. Retailers were forced to mark down many items to boost sales. Some did so as early as the first week of December. A discount retailer reported that at stores open at least a year, sales were down 1 percent from last year and over 3 percent below expectations. A more upscale apparel store reported sales were off over 7 percent from expectations.

Although sales of new vehicles through the first three quarters of 2000 were better than or just slightly below the record pace of 1999 for District dealers, sales slowed in this year's last quarter compared to 1999's. Moreover, it was reported that sales worsened as the quarter progressed. Finally, results for each dealer varied widely depending upon incentives offered by manufacturers. A current concern for area dealers is the bloated state of their inventories. Most reported having a 75-day or greater inventory, yet a 60-day inventory is preferred. Weak sales are anticipated to continue for the next couple of months.

Labor Markets

The slowdown in retail spending has not translated into an easing in the labor market. Firms continue to struggle to find and keep qualified employees. Demand for temporary workers remained unchanged from the tight levels reported November and October.

According to several union contacts, wage growth in current contracts has increased, most in the range of 3.5% to 4%--a rate still below the 4.7% that total private hourly earnings rose in the fourth quarter. While benefits growth appears to be concentrated mostly in pensions, health care remains an area of concern. Cost shifting, co-payments, and stop-loss arrangements have increased the costs borne by union members.

Banking and Finance

Commercial loan activity slowed in December as manufacturing firms received fewer orders and delayed investment because of slower anticipated economic activity and

lower interest rates. Demand for consumer loans also declined, but less than commercial loans.

Credit standards and delinquency rates have not changed significantly, but banks are watching their customers' ability to make payments more closely. Also, banks are paying more attention to the value of the collateral for loans.

Construction

Commercial builders throughout the District reported mixed conditions. While some contractors reported dramatic declines in economic activity, others reported largely stable economic conditions. There have been no substantial layoffs, but firms do not anticipate hiring additional workers. With the exception of prices for petroleum-based products, most materials prices have stayed relatively flat.

District homebuilders continued to report little change in business conditions. Some are concerned, however, about how much work they will have in 2001. At this time last year, many homebuilders had nearly twice as many projects scheduled for the upcoming 12 months as they do now; of course, last year was exceptionally strong.

Trucking and Shipping

Most shippers reported a slowdown in business in December from November, and nearly all reported a decrease in shipping activity compared to December 1999. In November and December, revenue decreased slightly less than shipping activity, or not at all, due to price increases and fuel surcharges. Shipping volume declined, confirming the slowdown in steel-, manufacturing-, and automotive-industry-related products.

Over the last month, fuel costs have stabilized and even gone down slightly for some companies. But even with lower fuel prices, unusually bad winter weather has

resulted in rising costs anyway. Most contacts expect the decline in shipping activity to continue into the first quarter of 2001.

FIFTH DISTRICT—RICHMOND

Overview: Fifth District economic growth continued to slow in December and early January. Seasonally-adjusted retail sales fell at automobile dealerships, and were weak at other stores, as sagging consumer confidence and unusually cold weather reduced spending. Service providers reported lower revenues and employment. Manufacturing output continued to slip somewhat in December and new orders dropped sharply, but manufacturers remained optimistic that conditions will improve by midyear. In the real estate and financial sectors, lower mortgage rates boosted December activity but lower consumer confidence damped expectations of business activity in coming months. Turning to District labor markets, strong wage gains continued in retail, but wage growth was moderate elsewhere. Consumer prices continued to rise at a modest pace.

Retail: District retailers reported that sales changed little in December from a year earlier. Also, heavier-than-normal price discounting was needed to sell much of their holiday merchandise. Contacts at big-box stores indicated that their holiday sales fell short of last year's levels. In addition, a large retailer in Columbia, Md., said that their sales fell sharply and noted that customers were "keeping their money closer to the pocket." In parts of the District, bad weather slowed customer traffic and put a damper on post-holiday sales. Automobile dealerships generally reported lower sales in recent weeks, and several said that their inventory levels rose as a result. Seasonally-adjusted retail employment growth slipped in December, but wages continued to rise at a brisk pace. Retail prices rose at a slower rate, in part because of extensive price discounting.

Services: District firms reported lower revenues in December. Contacts at services companies in Charlotte, N.C., said that banking industry restructuring had reduced demand for consulting and other services by the banking industry. Other firms noted cutbacks in hiring and little change in wage levels. Firms reported that prices rose only slightly in December.

Manufacturing: Activity continued to contract in December. Shipments declined at a slightly faster rate in recent weeks, and new orders and backlogs dropped sharply. A paper manufacturer in Charlotte, N.C., told us that new orders were at the lowest level since 1984. Several paper and rubber product manufacturers reported that increases in raw materials and energy prices were squeezing their profit margins. In the textiles

industries, contacts indicated that competition from abroad continued to hold prices in check. In spite of the recent declines in activity, most manufacturers remained optimistic about their future prospects and many expected orders and shipments to rebound by midyear. Both manufacturing employment and the average workweek slipped, while wages rose moderately.

Real Estate: Residential realtors and homebuilders reported that growth slowed in December, as the beneficial effects of lower mortgage interest rates were more than offset by falling consumer confidence and colder-than-normal temperatures. A realtor in Asheville, N.C., noted that buyers were looking longer before making a purchase. A counterpart in Greensboro said that sales in that area fell “a fair amount” and inventories of starter homes remained high. Homebuilders throughout the District reported sluggish growth in housing starts. Contacts said that subcontractors were available and that the costs of building materials were slightly lower. Home prices were steady across the District.

Commercial realtors reported softer growth in leasing and construction activity in recent weeks. Realtors in the District of Columbia said that the demand for office space had slowed in part because a number of struggling “dot-com” companies had recently backed out of rental contracts. Commercial realtors in Maryland, Virginia, and the Carolinas reported substantially slower growth in all types of commercial construction, with very few speculative projects currently underway. On a stronger note, contacts in Raleigh, N.C., and Columbia, S.C., reported a pickup in leasing activity in the retail sector and they said that the supply of Class A office space remained tight. Commercial rents across the District were generally stable to moderately higher.

Finance: District loan officers reported that lending activity grew at a somewhat slower pace in December. Commercial bankers noted that the demand for loans remained at a moderate level but they were increasingly “watchful” for signs of deteriorating financial conditions in cyclical industries, particularly construction and manufacturing. A commercial lender in Greenville, S.C., reported that a smaller percentage of manufacturing plants in that area were expanding, slowing the demand for loans. A banker in Chesapeake, Va., said that she was still lending to companies in weakening industries, but was making sure her bank was “compensated for assuming additional

risk.” Residential mortgage lenders reported moderately slower demand growth; several, however, noted that further declines in interest rates this year would likely spark more refinancing in coming months.

Tourism: Tourist activity strengthened further in December. Contacts at area ski resorts reported strong patronage in recent weeks, particularly during the week between Christmas and New Year’s Day. A manager at a ski resort in Virginia said that occupancy rates for his resort’s time-share units reached a record high during the holidays. He attributed the increase to colder-than-normal weather and a good snow base. A contact at a West Virginia ski resort reported a sharp rise in spending at retail shops there. Along the District’s coast, tourism remained vibrant despite the unusually cold weather.

Temporary Employment: Demand for temporary workers continued to be mixed in recent weeks. A Charleston, W.V., agent said that he had seen the demand for temporary industrial workers rise sharply in recent weeks. Agency contacts in Maryland and North Carolina, however, reported weaker demand for workers although several noted that the holidays were partly to blame. A Hagerstown, Md., agent added that he expected a slowing economy to lead to further declines in his business in the first quarter of the year. Wages of temporary workers remained generally steady since our last report.

Agriculture: Generally mild weather in the first week of December allowed District farmers to make good progress on late fall fieldwork. By mid-month, they had harvested most fall crops and had seeded small grain and winter grazing crops. Later in the month, however, snow cover and colder-than-normal temperatures led to greater use of feed and hay.

SIXTH DISTRICT – ATLANTA

Summary: The District economy expanded modestly during December amid further signs of economic deceleration. As expected, holiday sales results did not achieve the high levels of growth experienced last year, and the outlook for the first quarter was soft. Single-family construction and home sales remained sluggish, and nonresidential construction declined in most parts of the District. Manufacturing weakened, and the near-term outlook was for further reductions in factory activity. Overall loan demand, credit availability, and loan quality were at relatively healthy levels but with reports of stricter lending standards and slowing demand in some areas. Reports from the tourism and hospitality sector were generally positive. Labor market conditions eased slightly.

Consumer Spending: Holiday sales growth was low compared with the rates experienced last year, and several retailers said that sales did not even meet their lackluster expectations. Results varied considerably from store to store, but discount department stores generally performed better than department store and mall retailers. Strongest sellers included apparel and toys, whereas jewelry and home-related product sales were sluggish. Many retailers expressed concern about the impact of widespread discounting on profits. At year-end most merchant contacts described inventories as being broadly in balance, but little growth was expected in the first quarter.

Construction: Single-family construction and home sales remained sluggish. Most of the builders contacted said that construction and new home sales fell during November and December on a year-over-year basis. Additionally, more builders reported declines in buyer traffic and greater use of price concessions than in earlier reports. According to real estate agents, fourth-quarter home sales fell below the year-ago level. Builders continued to report that housing inventories were in

SEVENTH DISTRICT—CHICAGO

Summary. Economic activity in the Seventh District slowed further in December, in part due to severe winter weather adversely impacting virtually all economic sectors. Retailers reported that brutal weather kept store traffic down and, with few exceptions, holiday sales fell below merchants' expectations. Builders and realtors also cited the weather as contributing to a general slowdown in construction and real estate activity. Recent softening in the auto industry contributed to a further slowing of the District's overall manufacturing activity. Lenders reported moderating growth in business loan volumes while many noted a discernible increase in mortgage refinancing applications. Labor markets, while remaining very tight, appeared to ease somewhat as 2000 drew to a close, alleviating some worker shortages and wage pressures. With the notable exception of heating costs, price pressures appeared to ease slightly as economic conditions softened. Many contacts noted a discernible drop in both consumer and business confidence since our last report. Contacts were more optimistic after the Federal Reserve's unexpected rate cut in early January, but remained cautious in their business expectations for the first half of the year.

Consumer spending. Overall retail sales were very sluggish in the Seventh District through December, contributing to one regionally-headquartered retailer announcing it was going out of business and a few others announcing store closings. Retailers with a national presence suggested that sales in the Midwest fell below the nation's "disappointing" results, as brutal winter weather gripped the region and discouraged shoppers from leaving their homes. With a few exceptions, both discounters and department stores reported lackluster year-over-year sales results. Preliminary reports indicated that nearly 60 percent of respondents to a survey of small retailers in Michigan had fewer shoppers over this holiday season than last year, and an even greater share reported slower sales. Regionwide, cold-weather items (outerwear, auto batteries, etc.) were selling well, and there were reported shortages of some items such as snow throwers, shovels, and sleds. However, sales of electronics, home decorating items, and men's apparel were said to be slow. Contacts reported that shipments of consumer-related durables were fairly strong in December, but one transportation company noted that an increasing share of their business was picking up excess inventory from big-box retailers and returning it to the manufacturers. Contacts also indicated that the region's auto sales were slower than the national

average, with demand for domestic nameplates much softer than foreign nameplates. There were a few indications that price pressures at the retail level may have eased somewhat recently. Retailers generally reported that the economic environment necessitated greater price cutting this holiday season, and a contact in casual dining noted that a planned price increase was “put on the back burner” as the economy slowed. However, home heating bills rose sharply in December and may have contributed to slower growth in spending on other consumer goods and services.

Construction/real estate. Overall construction and real estate activity appeared to soften further in December, but contacts suggested this may have been largely due to inclement weather. Store closings by major retailers were expected to free up millions of square feet of space in the region in the first half of 2001. While this was a source of concern for some real estate contacts, others were looking at it as an opportunity. Consumer traffic was generally low at the stores being closed and freeing the space up for new tenants may reinvigorate many strip malls, according to some analysts. On the residential side, sales of new and existing single-family homes were again relatively soft, but realtors and builders were quick to point out that sales remained at high levels. In addition, contacts noted that severe weather may have discouraged many would-be buyers from house hunting in December. By contrast, development of multifamily residences remained very strong in the Milwaukee and Chicago downtown areas.

Manufacturing. Manufacturing activity slowed further in recent weeks with virtually every segment showing signs of softening. Even the auto industry, the region’s star performer in recent years, was sluggish. Nationwide, December’s light vehicle sales for domestic nameplates were significantly below year-ago levels, with particular softness in passenger cars. With weaker sales and sales expectations, as well as excessive inventories, automakers were planning “significant” downtime for some assembly plants in the first quarter. New orders for heavy equipment continued to slow substantially across practically all categories, but inventories were said to be in good shape due to earlier production cutbacks. December shipments of gypsum wallboard were below a year ago, and prices continued to erode. Demand for steel products, while still strong, softened somewhat, and foreign competition continued to put a strain on domestic producers. One industry analyst suggested that conditions in December were the worst for domestic steel producers since the early 1980s. According to this contact, unprecedented downward price pressures, due in large part to a flood of imports, forced some companies to file for bankruptcy and has left very few domestic steel producers “economically viable.” Lower

steel prices, however, translated into lower input costs for producers of other manufactured goods, including office furniture. In contrast to other industries, demand for office furniture remained strong, despite modest softening in new orders toward the end of 2000.

Banking/finance. Overall lending activity remained strong in the District, but not quite as robust as in early 2000. Growth in business loan volume continued to slow in late December according to most contacts, despite strong demand from small and medium-sized businesses. Overall quality on business loans generally was described as good, but many bankers were “keeping their eyes on” specific industries (especially retail and manufacturing) for any signs of deterioration. Business credit standards may have tightened further in recent weeks, and one lender suggested that some loans approved a year ago would have “zero chance of being approved now.” On the household side, lending activity was mixed. Some bankers reported a notable decrease in new mortgage originations as 2000 drew to a close. Contacts were unclear, however, as to whether this drop was due to deteriorating market conditions or simply to harsh weather conditions. At the same time, many lenders noted increased refinancing activity as fixed-rate mortgage interest rates continued to move lower. Several contacts expressed optimism that refinancing activity would pick up further in the first quarter. Some banks, particularly smaller ones, again reported difficulty in attracting deposits to fund loans. With recent stock market volatility, a few lenders were anticipating a boost in deposits as investors were expected to seek less risky investments. However, one analyst suggested that funds that fled the stock market found their way into other investment vehicles, but not into bank deposits.

Labor markets. Labor markets generally remained very tight in the Seventh District, although there were increasing reports that some slack may have developed. After falling more or less steadily for three straight years, initial claims for unemployment insurance benefits rose dramatically above seasonal trends in November and December. Many of these claims were the result of layoffs in manufacturing industries. Some retailers announced that layoffs were in the offing, but most industry analysts were confident that these workers would be quickly reabsorbed. Some service industries that had difficulty attracting workers in the past reported greater success in the last few weeks of 2000. Staffing agencies indicated that new orders for temporary help softened toward the end of December, although one agency noted that clients weren't sending workers back, they just weren't placing new orders for additional help. Contacts suggested that wage pressures appeared to ease modestly as a result of softer demand for

workers. Additionally, in contrast to our previous reports, there were no further reports of intensifying pressure on non-wage employment costs.

EIGHTH DISTRICT - ST. LOUIS**Summary**

The District economy shows several signs of slowing. Sales during the recent holiday season have been weak and below expectations, leaving many retailers with overstocked inventories. Early winter weather hurt. New and used vehicle sales are also slow, and inventories are high. Declines in demand have affected many industries; however, these declines have helped to ease labor market tightness somewhat. Many firms' profits are being squeezed by high fuel costs. Although new housing construction continues to slow, home sales have recently picked up in some areas. Loan demand has softened somewhat, while loan growth has been very mild. Several makers of fertilizer have stopped producing and, instead, have been selling their natural gas stocks on the market to boost profits.

Consumer Spending

Retailers report weak sales during the 2000 holiday season. Despite a last-minute pickup in activity just before and after Christmas, contacts report that, overall, sales are down 5 percent on average from a year earlier. Inclement weather resulted in many stores losing sales over several periods during the season, which partially accounts for sales growth that was below expectations. The weather did spur strong sales of seasonal products, such as winter coats, clothing and boots. Contacts at several major department stores report that electronics and small appliances have also been popular sellers. Fine jewelry and women's apparel, however, have not moved well. About half of the contacts report that current inventories are at desired levels, while others plan to reduce excess inventories by significantly discounting items in early 2001. Contacts report that the use of debit cards for purchases has increased substantially this season over last, even though their overall use is still small. Most retailers are guardedly optimistic that sales in the first quarter of 2001 will rebound, if weather conditions are favorable.

Car dealers report that sales during the last two months of 2000 are down more than 5 percent on average from a year earlier. Used car sales, in particular, have experienced the largest

VIII-2

decline. An early blast of winter weather, coupled with economic uncertainty and an anticipation of lower interest rates, are believed to have kept buyers away from showrooms. About two-thirds of the dealers note that current inventories are above desired levels. Most contacts are cautiously optimistic that sales in the first quarter of 2001 will rebound because they plan to offer more incentives—such as a wider use of rebates—to help boost sales and reduce inventories.

Manufacturing and Other Business Activity

Contacts in a variety of industries are experiencing a noticeable slowdown in demand. Slowing demand has helped ease labor markets somewhat, which has enabled firms to fill some of their vacant positions. Contacts continue to cite high fuel costs as a major problem. Although many firms pass on these higher costs to customers as surcharges, profit margins are still being squeezed.

Weak demand for automobiles has caused two manufacturers to idle several plants for at least one week. The local steel industry continues to weaken, with several producers going out of business in the past few months because of lower demand and foreign competition. The wholesale trade industry in northeast Arkansas and the furniture manufacturing industry in northeast Mississippi are both experiencing reduced profits because of slower demand. The District's apparel industry continues to shrink, as a Fruit of the Loom plant in Arkansas closes to eliminate excess production capacity.

Employment growth has been boosted by several firms expanding and relocating to the District. Memphis, for example, is increasing its status as a regional distribution hub, as a food distributor constructs a new warehouse and distribution center that will create 600 new jobs. A contact at a credit card company notes that it will employ more than 1,000 new workers at its global technology center in the St. Louis area during 2001. The District's high-tech sector continues to be volatile: Companies moving to the Louisville, Memphis and northwest Arkansas areas will create nearly 1,000 jobs in the coming months; several Internet companies currently in the St. Louis, Memphis and Louisville areas, however, have already cut their workforces, eliminating more than

600 jobs in the past two months. Despite slower demand in other sectors, General Electric is anticipating a strong year, as it plans to roll out more than 40 new products this year at its Kentucky Appliance Park.

Real Estate and Construction

Real estate agents report that home sales have recently picked up in some areas, especially Memphis and Little Rock, where year-to-date sales are above last year's levels. Median home prices in many District areas are currently down from their year-earlier levels.

Residential construction continues to slow, with permits down from their month- and year-earlier levels in all District metropolitan areas. Builders, however, have expressed optimism about construction activity in 2001 because of expectations of lower mortgage rates. Nonresidential construction has been mixed, with pockets of activity in some areas, such as Little Rock, and substantial slowing of the market in others, such as St. Louis. As a result of the slower residential and nonresidential construction, fewer contractors are experiencing backlogs.

Banking and Finance

Total loans outstanding at a sample of small and mid-sized District banks are essentially unchanged, growing only 0.4 percent between mid-October and mid-December, thus continuing a trend of mild growth. Several contacts are reporting that loan demand has recently softened somewhat. Growth in commercial and industrial loans and real estate loans has been stagnant during this period. Consumer loan growth, however, is down about a percentage point; it had been up about 1.4 percent between mid-August and mid-October. At the same time, total deposits have grown about 1 percent, which is a slight uptick in this growth rate.

Agriculture and Natural Resources

A contact reports that nitrogen fertilizer prices have increased substantially over the past year, particularly during the fall, because the price of natural gas—a major cost-component of nitrogen-based fertilizer products—has more than quadrupled. In fact, some manufacturers have begun selling off natural gas stocks rather than producing fertilizer because this strategy is currently

VIII-4

more profitable for them.

Low water levels and ice on the Mississippi River have made travel difficult for barges and tugboats, hampering cargo shipments of commodities such as corn, soybeans and wheat. These conditions have also caused some barges to run aground earlier in the season than usual.

NINTH DISTRICT--MINNEAPOLIS

Economic growth in the Ninth District is weakening. Manufacturing levels and mining production are decreasing. Consumer spending is flat, and housing construction and agriculture continue to grow at a slow rate. Some signs of strength persist: The energy, tourism and commercial real estate sectors are expanding at a solid pace. Labor markets are still tight, although several layoffs were announced. Wages are increasing at a moderate pace. Overall price increases are moderate, but significant increases are noted for energy, residential rents, health care and package delivery.

Construction and Real Estate

Construction continues to grow at a moderate pace. Building contracts awarded in the Dakotas and Minnesota increased 13 percent for the three-month period ending in November compared with the same period last year. A real estate consultant in Sioux Falls, S.D., projects strong demand in 2001 for retail space and flat demand for office and industrial buildings. Vacancy rates in the third quarter of 2000 for office buildings in the Minneapolis-St. Paul area have reached a four-year high at 8.8 percent. Meanwhile, a Minneapolis-St. Paul construction company representative reports growth in construction activity has recently decreased to the moderate levels of 1997.

Homebuilding increased slightly from the last report. Housing units authorized were up 2 percent in the district for the three-month period ending in November compared with a year earlier. Housing permits in the Minneapolis-St. Paul area were expected to finish 2000 at near record levels, and favorable mortgage interest rates are boosting home sales, according to a mortgage consultant. In contrast, almost 50 percent of respondents in the Minneapolis Fed's annual business conditions survey conducted in November expect housing starts to decrease in 2001.

Consumer Spending and Tourism

Consumer spending in the district was flat to down slightly compared with last year. Registrations of new cars and trucks are about even with last year in North Dakota and down 6 percent in South Dakota. A major Minneapolis-based department store retailer noted that December same-store sales were flat compared with last year. Sales were off almost 10 percent for December compared with a year ago at a North Dakota mall. Last-minute purchases brought December mall sales in Duluth, Minn., from a decrease of 9 percent to about even with a year ago. Almost 30 percent of respondents to the

Minneapolis Fed's business conditions survey expect consumer spending to decrease in their communities in 2001, up from 15 percent in last year's survey. Three major national retailers announced the closing of several unprofitable stores across the district.

An early start to winter recreation activities has boosted tourism. A ski resort in Montana reports bookings for January and February up 4 percent from a year ago. Winter sports participation in South Dakota is up 25 percent in December compared with a year earlier. An official reports that winter tourism in the Upper Peninsula of Michigan was ahead of last year for November and December, but softer during the holidays.

Manufacturing

Overall manufacturing activity in the district decreased. A December purchasing manager survey by Creighton University indicated slower manufacturing activity in Minnesota and in South Dakota. As evidence, a Minnesota automobile assembly plant will stop production for one week in January. In 2001, a refrigeration, air conditioning and heating equipment company will shut down a Minnesota factory in the first quarter, and an industrial equipment manufacturer in Minnesota plans to reduce production. In addition, a boot producer cut production at a western Wisconsin plant. A Montana cement company and a cardboard box manufacturer temporarily shut down due to very high electricity costs. However, due to heavy snowfall, a Minnesota snow removal equipment manufacturer sold out its inventory two months earlier than normal.

Mining and Energy

The energy sector continued to expand, while the mining industry contracted. District oil and natural gas exploration and production increased as prices for these products remain at high levels. Meanwhile, due to softening demand, high electricity costs and low commodity prices, mining production is decreasing. A Minnesota iron ore mine shut down earlier than expected and another two mines reduced production due to softening demand. A Montana aluminum smelter cut production 50 percent, and a copper mine remains shut down due to high electricity prices. However, palladium/platinum production remains at full capacity, according to a Montana mining official.

Agriculture

Snow and prices paint a mixed picture for agriculture. Heavy snow cover across most of the district slightly reduced the likelihood of another summer drought and aided the winter wheat crop, but added stress to livestock producers. In addition, the U.S. Department of

Agriculture predicts continued low corn, wheat and soybean prices in 2001 but expects healthy livestock prices. Meanwhile, dairy producers have been buffered from lower milk prices by a federal government dairy market loss-assistance program.

Employment, Wages and Prices

Labor markets remain tight, although several companies reported layoffs in December and early January. A northern Minnesota mine closed affecting about 1,000 workers and a direct marketing firm is laying off 550 warehouse workers in St. Cloud, Minn. A Minneapolis area-based online education firm reduced staff by 14 and placed its remaining 120 employees on a two-week unpaid leave; an e-commerce business will lay off 91 employees, almost half its workforce. A Minnesota printing and service firm is reducing staff by 50 jobs. A footwear company in La Crosse, Wis., recently laid off 200 employees. The upcoming shutdown of a Montana lumber mill will leave 140 out of work.

Still, several companies are looking for new employees. A new high-tech company in Rapid City, S.D., plans to hire 100 employees in the two years. The construction of a poultry litter-fired power plant in western Minnesota will require 300 workers. Some manufacturers are expanding outside the district due to a lack of available labor, according to a bank director.

Wages continue to increase at a moderate pace. About three of five respondents to the Minneapolis Fed's business conditions survey expect a modest increase in wages for their communities in 2001. A December survey of manufacturers in the Dakotas, Minnesota and Wisconsin shows that about 48 percent of respondents have raised wages over the past two months compared with 53 percent a year ago.

Overall price increases are moderate, but significant increases are noted for energy, apartment rental rates, health care and package delivery. The cost to heat homes this winter has doubled in many district locations. Apartment rental rates increased 11 percent in the Minneapolis-St. Paul area in December compared with a year earlier. A hospital in La Crosse is increasing rates by an average of 12 percent over a year ago, the largest single increase in over a decade. Two major package delivery companies are raising rates up to 5 percent. A December St. Cloud State University *Quarterly Business Report* survey showed that 23 percent of respondents in central Minnesota noted increases in product prices, down from 29 percent a year ago.

TENTH DISTRICT - KANSAS CITY

Overview. The Tenth District economy slowed in December. Manufacturing activity fell, residential building declined further, and sizable layoffs were announced at several district firms. Auto sales also dropped sharply, and overall retail sales were sluggish during the holiday season, despite heavy discounting. On the positive side, commercial construction activity remained solid, and energy activity continued to rise. In the farm economy, poor pasture conditions have limited expansion of cattle breeding herds. District labor markets remained tight, but wage pressures appeared to ease somewhat, especially in the retail sector. Prices were flat, except for declines in some manufacturing materials.

Retail Sales. Retail sales in December were only slightly higher than a year ago in most locations. Sales of home electronics were solid and winter clothing sold well with the onset of unusually cold weather, but sales of other items were generally weak despite heavy discounting. In contrast to bricks-and-mortar retailers, several Internet retail firms based in the district reported that growth in online purchases matched or exceeded expectations. Looking ahead, store managers expect sales to pick up again by Easter. Motor vehicle sales continued to slow and were much weaker than a year ago. Dealers reported difficulties moving all makes and models, despite significant manufacturer incentives. Inventories of unsold cars were up throughout the district, and many dealers have delayed purchasing new vehicles. Expectations for sales in coming months remain subdued.

Manufacturing. District factory activity fell in December, with fewer firms reporting high levels of capacity utilization than in the recent past. Weaker demand, higher input costs, and the strong dollar all contributed to the slowdown. The most prominent increase in input costs was for natural gas, as some fertilizer and chemical plants reported they were drastically reducing production

to sell their natural gas supplies on the open market. No material availability problems were reported, and lead times were virtually unchanged. Managers do not anticipate material availability problems in coming months. Firms continued to trim inventories and many plan to trim further through the spring.

Real Estate and Construction. Residential construction activity continued to slow in December, while commercial building remained solid. Housing starts fell in most of the district and were well below year-ago levels in some areas. Builders expect a flattening out of residential building activity over the next three months. Sales of new and existing homes remained solid in western parts of the district, but were slow elsewhere. Mortgage demand was mixed relative to the previous month, but still down considerably from a year ago. Lenders expect refinancing activity to increase in coming months in response to the recent easing in mortgage rates. Commercial construction activity held steady, and vacancy and absorption rates remained largely unchanged. There was, however, some concern about overbuilding in the retail sector.

Banking. Bankers reported that loans edged down and deposits increased in December, reducing loan-deposit ratios somewhat. Demand eased for all major loan categories except home equity loans and agricultural loans, both of which were flat. On the deposit side, demand deposits, NOW accounts, money market deposit accounts, and small time and savings accounts were all up, while large CDs were unchanged. Most banks attributed the deposit increases to seasonal factors. All respondent banks left their prime lending rates unchanged in December, and almost all banks held their consumer lending rates steady. Lending standards were generally unchanged.

Energy. District energy activity continued to rise as rapidly as drillers could find workers and rigs. The count of active oil and gas rigs in the district rose 10 percent in December to reach an eight-year high. District sources reported that the national rig fleet is now fully employed. Further expansion will require the manufacture of additional equipment. Natural gas prices doubled to more

than \$10 per mcf in December, but producers said this price increase would have little effect on their investment decisions because prices were already high enough to justify expansion.

Agriculture. The district's winter wheat crop was hurt by dry weather in the fall months. While fewer wheat fields are suitable for grazing as a result of the damage, other forages are in ample supply for winter. Nonetheless, the poor pasture conditions have made district cattle ranchers reluctant to expand their breeding herds. District bankers indicate big government payments and strong livestock profits have limited serious problems in farm loan portfolios, but they expect low crop prices to hold down incomes for crop producers. District farmland prices edged up as a result of some farmers expanding their operations and nonfarm investors purchasing land for recreation uses.

Wages and Prices. District labor markets remained tight in December. However, contacts reported that recently announced layoffs at district retail establishments, communications firms, automobile plants, and Internet startups could help alleviate labor pressures in some areas. The greatest labor shortages were for skilled positions in information technology, manufacturing production, health care, and oil and gas drilling. Specific jobs experiencing acute shortages included masons, framers, welders, machinists, nurses, and pharmacists. The proportion of business contacts reporting increased wage pressures was down from the previous survey, particularly in the retail sector. However, wages rose considerably for oil and gas field workers. Retail prices were down in December, due to early discounting in the holiday shopping period. Store managers expect prices to remain steady through Easter. Prices fell for several manufacturing inputs, including steel and plastics, but are expected to stabilize in coming months. Building material prices were largely unchanged.

ELEVENTH DISTRICT—DALLAS

Overall Eleventh District economic activity continued to decelerate in December and early January. Manufacturing activity declined, with a considerable drop in demand for some industries. Weaker sales growth was reported in the service sector; demand for business services and retail sales decelerated. Construction and real estate activity also slowed, with a substantial slowing in the demand for residential building. Financial service firms said activity was slightly slower and, while credit quality remains stable, most respondents reported continued tightening of credit standards. The energy industry remains a bright spot, with international activity picking up, but a lack of labor and machinery is constraining drilling activity. Freezing weather hampered agricultural conditions.

Prices. Price declines have become widespread, and several manufacturing industries reported rising inventories. Metals producers said weaker than expected demand left inventories higher than desired, and prices are low and falling. Cement and concrete inventories are also high, and selling prices have decreased despite high energy and fuel costs. Prices declined for some paper products, and some firms reported that inventories are a little too high. Lumber producers say inventories are very high and selling prices have dropped “like a rock.” Falling construction costs are being passed on to new homebuyers because builders are reducing prices to help stimulate sales. Some telecommunications firms said their inventories are in good shape, but others said inventories are too high. Telecommunications prices are falling fast while costs are just slightly lower. Some telecommunications firms said they are outsourcing production to lower costs. Most retailers said selling prices have been lower than a year ago.

Spot prices for West Texas Intermediate crude oil has declined nearly \$10 (more than 25 percent) per barrel since peaking in late November, but remained strong by standards set over the past two years. Crude inventories, which have been very tight, increased slightly in December and are expected to normalize. Oil product prices are generally following the price of crude downward. Ethylene prices fell throughout the second half of 2000 and are expected to continue falling. Feedstock prices for ethylene and propylene have reached unprofitable levels as producers have watched in horror as natural gas prices doubled from what was thought to be an incredibly high \$5 per Mcf up to \$10. (The highest prices ever

reached—even when adjusted for inflation.) A number of plants that convert natural gas into other products have been shutting down, reducing U.S. methanol capacity by 50 percent and ammonia capacity by one-third. Ethylene capacity has been reduced by 10 to 15 percent.

Glass producers noted higher fuel costs, which some firms are passing forward. Business service firms said that fees have been rising but not as fast as their costs. Transportation service firms have increased prices and fares to cover rising fuel costs. Prices are rising for energy-related labor, products and services.

Labor Markets. Labor markets loosened in December and early January but are still tight, according to contacts. Some industries, such as glass, lumber, metals and telecommunications, reported layoffs. Some manufacturers have reduced worker hours because production has slowed. Others are making preparations to shut down production and lay off workers in case the situation worsens. Wage pressures have eased in many industries. Telecommunications firms say they are hiring at a new, lower pay schedule. Several business and transportation service firms were also hiring. Most service firms said salaries are still high, but wages have not risen notably.

Manufacturing. Manufacturing activity has decreased since the last beige book, with nearly all contacts reporting falling demand. Bad weather, the weak stock market and a weaker outlook for the U.S. economy were cited as explanations for the drop in demand. Import competition and new capacity coming on line were exacerbating supply imbalances for some industries, such as lumber and steel. Sales growth weakened sharply for producers of high tech equipment, such as computers, semiconductors and communications equipment. Businesses have begun to curtail technology-related investment, according to contacts, who added that consumer demand for PCs has been weakening since the Fall of 2000. Demand for construction-related products, such as glass, lumber, cement, concrete and metals, softened significantly, which contacts attribute to a combination of seasonal factors, tighter credit, declining consumer confidence, import competition and bad weather. Many lumber companies are shutting down plants. Steel producers say competition is very stiff, and smaller producers are particularly concerned about their outlook. Sales of corrugated boxes have also declined over the past month. Demand for apparel manufacturing slowed in the fourth quarter of 2000, and inventories are heavy for some firms. Demand for

petrochemicals has dropped in all markets, including housing, autos and consumer packaging. The petrochemical industry continues to struggle with a glut of capacity and soaring costs, and margins have fallen sharply. Excess capacity is expected to weigh heavily on the market through 2003. In contrast, refineries on the Texas and Louisiana Gulf Coast operated at high levels of capacity utilization in recent weeks, between 96 and 99 percent.

Services. Demand for business services was lower, and sales growth was weaker than reported in the last beige book. Demand for temporary services continued to be robust for energy-related firms in Houston. Demand from the manufacturing sector remained moderate, but contacts noted some slowing from telecommunications and PC firms. Legal and accounting firms reported slightly slower activity over the past six weeks, but said business was still “good.” Transportation firms—airlines, trucks and railroads—reported slightly slower demand over the past six weeks, which contacts attributed to bad weather and a slowing economy. Demand for services from the telecommunications industry also continued to decline, and contacts said demand growth was lower than a year ago.

Retail Sales. Retail sales were up slightly over last year, which retailers said were “slower than anticipated but not a disaster.” Weak sales growth was attributed to bad weather and slower consumer spending because of high utility costs and the weak stock market. Sales were noted as particularly weak for men’s and children’s apparel, while shoes and outerwear were areas of strength.

Financial Services. Growth of overall lending activity slowed slightly—with smaller institutions and credit unions reporting brisker activity than larger institutions. Commercial lending slowed some—with the exception of that related to the energy industry. Residential real estate lending remains stable to slightly up, which bankers said was due to lower long-term rates. Contacts say that credit quality remains stable, with no reports of increasing loan loss reserves or increased delinquencies. Most respondents reported continue tightening of credit standards.

Construction and Real Estate. Sales and construction activity slowed over the past six weeks, which contacts attributed to normal seasonal slowing and a drop in consumer confidence. Demand for home building slowed substantially, according to contacts. Non-residential activity also was weaker over the past few weeks. Most contacts say they are optimistic about the overall health of the real estate markets,

but expressed concerns about the recent slowing. Respondents contacted after January 3rd said they had revised their outlook upward following the interest rate cut.

Energy. The U.S. rig count flattened out at near 1100 working rigs. More exploration work is being done, as opposed to easy expansions of existing fields. International work is picking up, increasing demand for Houston-based services and equipment. Constraints to the number of active rigs have been reached, both in terms of people and equipment. Global competition for people, equipment and manufacturing capacity is expected to restrain domestic activity. Drilling expenditures from producer capital budgets is widely forecast to increase by 20 percent or more, but half or more of the increase is expected to be consumed by rising prices of labor, oil field services and machinery.

Agriculture. Cold, freezing temperatures damaged fruit trees, slowed planting and impaired livestock conditions. Supplemental feeding of livestock continued, but hay supplies were difficult to locate in some areas. Cold, wet weather delayed planting of the winter wheat crop, and in some areas it is now too late to plant. While crop growth was hampered, recent freezing weather isn't expected to affect yields.

TWELFTH DISTRICT — SAN FRANCISCO

Summary

Reports from Twelfth District contacts indicated continued expansion in most District states, although there are signs of slowing in several key sectors and of easing in tight labor markets. Contacts reported that holiday season retail sales were mixed, falling below expectations in many states. Conditions in the District manufacturing sector softened, and respondents noted some accumulation of inventories. Conditions in the District agricultural sector weakened further in recent weeks, as sales softened and prices remained low. Real estate and construction activity remained strong, especially in California and Hawaii. District contacts reported weaker loan demand and diminished credit availability for new office construction and for high-tech firms with weak profits. High energy prices reportedly have driven up costs for the manufacturing, transportation, and agricultural sectors. However, producers noted that competitive pressures have limited their ability to pass those higher costs on to consumers.

Wages and Prices

With the exception of energy, contacts throughout the District reported generally stable prices for inputs and consumer goods. Respondents also indicated some easing of tight labor markets and signs of slower job turnover rates since the last survey. These observations were attributed to increased uncertainty about the strength of the economy and slowing in the dot-com and technology sectors. One major high-tech manufacturer located in the District recently announced a hiring freeze and postponed raises for at least one quarter. Most respondents reported that wage increases have moderated somewhat, although several noted that health care costs continued to rise. In contrast, construction industry contacts in California indicated that labor shortages continued to put upward pressure on wages and construction costs.

Numerous District contacts cited concerns about energy shortages and costs. Respondents noted adverse impacts from soaring electricity and natural gas prices on the agriculture,

transportation, and manufacturing sectors. For example, the costs of harvesting seafood, drying foods, and transporting and manufacturing goods have risen. Several agricultural, manufacturing, and retail sector respondents indicated that competitive pressures continued to limit their ability to raise prices of final goods and services. Respondents expect higher energy costs to affect retail prices and construction costs in the year ahead. Despite electric power and natural gas shortages and steep increases in energy costs, relatively few District contacts have revised their energy procurement strategies.

Retail Trade and Services

District retailers reported mixed holiday season sales growth. In most District states, holiday sales were reported to be at or below last year's dollar volume; in contrast, contacts in California and Hawaii reported increased holiday sales. Respondents noted that consumers were more cautious about their spending this holiday season, especially on big-ticket items, including computers. New car sales were weak, despite efforts to boost sales volume with discount pricing and low-cost financing packages. Contacts throughout the District reported that retailers moved early and aggressively to discount merchandise, especially clothing and electronic goods. However, while sales incentives helped move products, lower prices for consumer electronics and computers resulted in lower revenues from those sales.

District contacts indicated that holiday season Internet sales increased compared to 1999. Increased sales were attributed to more website visitors, increased confidence in Internet transactions, and more frequent use of the Internet by traditional retailers. Despite the strong growth, holiday Internet sales fell below expectations.

Manufacturing

District manufacturing conditions weakened in recent weeks. Contacts reported slower sales growth in the biotech, machine tools, and automobile sectors and flat construction equipment sales. Respondents cited indications of rising inventories among providers of high-

tech equipment, construction equipment, and sporting goods. In contrast, shortages of raw materials used in the production of fiber optics equipment were reported.

Manufacturers expressed widespread concern about the negative effects of higher energy costs. Higher energy prices have driven up costs of producing most manufactured goods. One Nevada contact indicated that small business energy costs doubled in December, even with moderate weather. Production disruptions were noted: For example, one aluminum plant in the Pacific Northwest shut down its smelter operations because it was more profitable to resell the electricity under contract than to operate the plant.

Agriculture and Resource-related Industries

District farmers reported weaker conditions in the latest survey period. Low prices, weak sales, and an increase in order cancellations have lowered profits for fruit and vegetable producers. The strong exchange value of the dollar also has limited exports of District farm products. Producers continued to find it difficult to pass on higher energy costs to wholesalers and retailers. District ranchers have fared better in recent weeks, with strong demand for calves and low feed costs.

Real Estate and Construction

Residential real estate construction activity remains strong in the District, although year-to-date housing permit activity in 2000 is reportedly below 1999 levels in all states except California and Hawaii. Respondents in those two states noted strong real estate activity and shortages of skilled construction labor and subcontractors. In contrast to previous survey periods, building materials reportedly are becoming easier to obtain. Contacts in Northern California and Washington reported a shortage of commercial office space. Respondents also reported that financing for new office construction has become more difficult to find in recent months.

Financial Institutions

Credit demand in the District has reportedly slowed in recent weeks. Financial industry contacts reported lower demand for both consumer and business loans. Respondents noted that financial institutions tightened credit standards and began monitoring credit quality more carefully.