The Federal Reserve Board

September 6, 2006

Summary of Commentary on Current Economic Conditions by Federal Reserve District

Summary

Prepared at the Federal Reserve Bank of New York and based on information collected on or before August 28, 2006. This document summarizes comments received from businesses and other contacts outside the Federal Reserve and is not a commentary on the views of Federal Reserve officials.

Reports from the twelve Federal Reserve Districts indicate that economic activity continued to expand since the last report, but five Districts indicated deceleration while the remaining seven reported little change in the pace of growth. Some slowing in economic growth was seen in the Boston, New York, Philadelphia, Kansas City, and Dallas Districts, though Dallas still characterized growth as strong. Most other Districts reported continued modest growth, though Atlanta described activity as "mixed", Richmond observed that growth was "slow," while San Francisco noted a "solid" growth pace.

Consumer spending increased slowly in most Districts, weighed down by sluggish sales of vehicles and housing-related goods. While a number of districts noted some bloating in automobile inventories, most non-auto retailers indicated satisfaction with inventory levels. Tourism was generally characterized as steady but relatively strong. Reports on the service sector varied by industry and by district: some found the trucking and information technology industries to be relatively strong, but others provided mixed reports on transportation and health care. Manufacturing activity continued to expand in all districts, despite pockets of weakness mostly related to autos and residential construction. Reports on real estate and construction were uniformly weak for the residential sector, but fairly widespread strength was recounted in the commercial sector. Financial institutions reported some softening in loan demand, especially for home mortgages, but noted that credit quality was still favorable. Drought-like conditions in much of the nation have hampered crop production and livestock while energy production remained at a high level.

Labor markets were mostly described as steady since the last report, with scattered labor shortages and associated upward wage pressures noted in a number of Districts—especially for workers with specialized skills. Widespread increases in the prices of energy and certain other commodities persisted since the last report, though most of these increases do not appear to have passed through to finished consumer goods.

Consumer Spending and Tourism

Consumer spending increased modestly in most Districts since the last report, though a few Districts reported flat to declining sales. In general, sales of autos and home improvement and other home-related goods tended to be weaker than for other categories. A number of Districts also indicate that persistently high energy prices are perceived to have crimped consumer demand in general. Overall, retail sales were described as growing modestly in nine Districts: Boston, New York, Philadelphia, Atlanta, Chicago, Minneapolis, Kansas City, Dallas and San Francisco. The Richmond and St. Louis Districts noted weak or declining sales while Cleveland described sales as mixed. Vehicle sales were reported to have weakened in the Philadelphia, Cleveland, Richmond, St. Louis, and Kansas City Districts; however, a pickup in auto sales was indicated in the Chicago District. Vehicle sales were described as mixed in the Atlanta, Minneapolis, Dallas and San Francisco Districts; all four noted a shift in demand toward more fuel-efficient vehicles.

Aside from automobiles, retail inventories were generally reported to be at favorable levels, where specified—in the Boston, New York, Atlanta, Chicago, and St. Louis Districts. Kansas City reported a slight decline in the share of store managers satisfied with inventory levels. However, excessive vehicle inventories were reported in the Philadelphia, Atlanta, Chicago, and St. Louis Districts, and contacts in the Kansas City District anticipate a build-up of vehicle inventories in the months ahead.

Tourism was, on balance, little changed from the last report. The New York, Atlanta and San Francisco Districts indicated continued high levels of tourism activity. Activity was described as mixed in the Richmond and San Francisco Districts and as weaker in the Minneapolis and Dallas Districts.

Services

Activity in the service sector was mixed across Districts and across industries since the last report. Regarding the broad service sector overall, Richmond reported an acceleration in service firms' revenues, St. Louis and San Francisco indicated steady growth while New York indicated some slowing in activity. The transportation industry was mixed since the last report. Strong or increased overall activity was reported in the Atlanta, St. Louis, Dallas, and San Francisco Districts; Richmond reported that airports' revenues accelerated. In contrast, St. Louis and Dallas indicated some softening in the airline industry, and Cleveland noted some moderation in trucking and shipping activity. Boston reported steady growth in business at software and IT service firms. The Richmond and San Francisco Districts characterized the health care industry as robust, whereas the St. Louis District indicated impending layoffs in that industry.

Manufacturing

Manufacturing activity was reported as generally expanding in all Districts, and contacts were optimistic that activity would continue to grow in the months ahead. While the pace of manufacturing activity had slowed in the New York, Richmond, and Kansas City Districts, it was reported as increasing in the Philadelphia and Chicago Districts.

Factory activity was reported as declining in some sectors but increasing in others. Several Districts reported a decline in activity in the motor vehicle industry, although Cleveland noted that some of this decline was likely seasonal; Chicago said that heavy-duty truck production and demand for heavy equipment continued to be strong. Steel demand also remained strong according to the Cleveland and Chicago Districts. Activity was reported as rising in aircraft and defense sectors. Reports of slowing in activity related to residential construction and housing-related products were widespread, although demand related to non-residential construction activity was reported as improving. The production of apparel was also cited as having slowed. Energy-related manufacturing activity continued to rise strongly, and capital goods output was reported as generally growing in most Districts.

Real Estate and Construction

Housing markets and home construction activity weakened throughout the nation, but commercial real estate and construction strengthened in most Districts. Virtually all Districts reported declines in home sales, as well as in residential construction activity. Moreover, most Districts indicated substantial increases in the inventory of unsold homes; Kansas City attributed some of this increase to "sizable numbers of foreclosures" in some areas. In general, residential real estate contacts expected that housing markets would remain weak, if not weaken further, in the months ahead; such concerns were specified in the reports from Philadelphia, Cleveland, Atlanta, and Kansas City.

Relatively flat or declining home prices were noted in the New York, Richmond, and Kansas City Districts, and decelerating prices were reported in the Philadelphia and San Francisco Districts. The high end of the market was described as particularly weak in the Richmond, Chicago, and Kansas City Districts, as well as parts of the Minneapolis District. In contrast, the high ends of both the Dallas District's housing market and the New York District's co-op and condo market were reported to have experienced less softening than the more moderately priced segments. One area of relative strength in residential real estate has been the apartment market--of the three Districts reporting on this, New York and Chicago both indicate fairly strong demand for apartment rentals since the last report, while Dallas noted continued strong demand for condominiums.

Commercial real estate markets were uniformly described as strong and, in most cases, increasingly so. Office markets showed noticeable signs of improvement in the Boston, New York, Philadelphia, Atlanta, Chicago, Minneapolis, Dallas, and San Francisco Districts. However, market conditions were described as mixed in the Richmond and St. Louis Districts. The reports on markets for industrial space were not as uniformly positive: Philadelphia, Richmond, and Atlanta reported some firming, whereas Minneapolis noted some softening; industrial markets were described as generally steady in the New York and St. Louis Districts.

With widespread tightening in commercial real estate markets, most Districts also reported increases in commercial development and construction. Increased office construction was reported in the Boston, Philadelphia, Atlanta, Minneapolis, Dallas, and San Francisco Districts. Minneapolis also reported a pickup in industrial construction while Cleveland and Dallas reported increases in retail development. Public construction activity was described as strong in the Dallas and San Francisco Districts.

Banking and Finance

Banks reported mixed but generally slowing trends in lending activity during the summer, with softening demand most evident in the household sector, especially for home mortgages. The New York, Cleveland, Atlanta and Chicago Districts reported declines in overall loan demand, while the Philadelphia and Kansas City Districts reported increases. However, reports of soft and/or weakening demand for residential mortgages were more widespread, as highlighted in the New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago and San Francisco Districts. Although refinancing was generally described as soft, both Richmond and Chicago noted an uptick in such activity, which was attributed to homeowners looking to lock in fixed rates. Demand for commercial and industrial loans rose in the Philadelphia, Chicago, and San Francisco Districts but weakened in the New York and Kansas City Districts.

Overall credit quality was generally described as good, and delinquency rates were little changed in most Districts, though a few noted scattered increases. The New York and Philadelphia Districts reported modest increases in delinquencies on home mortgages, and Cleveland noted a slight increase in the commercial segment. Credit standards were reported to be steady to slightly tighter.

Agriculture and Natural Resources

Drought and near-drought conditions persisted throughout much of the country, depressing crop production and livestock sustainability. Conditions were distressed in the Atlanta, Richmond, Minneapolis, and Dallas Districts. Dallas reported that more than 50 percent of key crops were in poor shape, and the consequent acceleration of the liquidation of cattle is expected to cut beef supplies significantly over the next few years. Weather conditions improved somewhat in the Kansas City District; nonetheless, the region's crops continued to suffer from prior drought conditions, and cattle producers there also plan faster liquidation of herds. St. Louis reported mixed conditions. The bright spots were in the Chicago District, where above-average rains reduced stress and improved the crop outlook from earlier drought conditions, and in the San Francisco District, where conditions were reported as favorable.

The demand for oil and natural gas was reported as continuing to be robust, and facilities were operating near capacity. But several reports indicated some softening in natural gas prices. Drilling and exploration activity was reported as rising slightly, but constrained by capacity constraints, with the Dallas District noting that some drilling activity had shifted away from natural gas and toward oil. Mining activity was reported as robust.

Labor Markets

Labor markets around the nation have generally been steady since the last report. Scattered labor shortages continued to be reported in a number of Districts, though these do not appear to have intensified, except in the Dallas District. Job growth was described as brisk in the Kansas City District, and recent acceleration was noted in the Richmond District. Labor markets were characterized as steady or expanding moderately in the other ten Districts. The Kansas City and Dallas Districts reported fairly widespread labor shortages while more specific shortages were cited in a number of other Districts: Cleveland indicated a shortage of truck drivers, Atlanta noted ongoing shortages of construction and hospitality workers along the Gulf Coast (where Hurricane Katrina struck a year ago); Chicago reported shortages of skilled manufacturing workers and engineers; and Minneapolis mentioned some shortages in Michigan's northern peninsula.

Wage pressures were reported in a number of Districts, though they were most often limited to certain sectors and most pronounced for workers with specialized skills. Overall increases in wage pressures were mentioned in the Philadelphia, Chicago, Minneapolis, Kansas City, and Dallas Districts. A number of other Districts reported sharp wage increases or wage pressures for such workers in occupations that are in short supply or for workers in particular industries, such as information technology (Boston), trucking (Cleveland), retail trade (Chicago), and financial and health services (San Francisco).

Prices

Reports of sustained increases in the cost of metals, energy and petroleum-based products, and other raw materials continued to be widespread, although increases in energy costs were reported as moderating in the San Francisco District. Some Districts reported flat to declining prices for natural gas and a moderation in the price of steel. Manufacturers found little ability to pass through higher costs into the prices of manufactured goods, with the exception of energy-intensive goods and services as reported by the San Francisco District. Many Districts reported lower prices for apparel and electronic goods, and most Districts reported that retail prices remained steady.

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First District--Boston

Reports on business conditions in the First District through the middle of third quarter are more mixed than six weeks ago, but still largely positive. Most retailers, manufacturers, and staffing firms report gains in revenues or sales from a year earlier, although selected respondents—most in housing-related areas—indicate that business is flat or down. Software companies are realizing strong growth and commercial real estate markets continue to firm. Rising input costs are an ongoing concern, although many contacts indicate they are able to raise their selling prices. With the exception of selected highly skilled occupations, increases in base pay remain moderate.

Retail

Retail respondents in the First District generally report sales slightly ahead of year-earlier levels for the summer months, with same-store sales increases ranging from 1 percent to 8 percent. The one exception is a contact in the lumber and home improvement industry who reports same-store sales down almost 20 percent from last year, a change he largely attributes to a downturn in the housing market.

Inventory levels are generally satisfactory. The majority of retail contacts report cost increases for energy-related products; increases are also reported for liquid sugar, paper, poultry, and beef, while dairy and lumber costs are down. When possible, contacts have passed along small price increases to their consumers. For the most part, employment has been steady, with some hiring occurring in relation to new store openings. Capital spending is mixed, with several companies scaling back capital spending plans in response to slower sales growth.

While responding retailers say they expect current conditions to persist, most also express more caution regarding the outlook than previously.

Manufacturing and Related Services

First District manufacturers and related services providers report mixed business trends in the second quarter and early third quarter. Sales of home furnishings, home construction products, and consumer-oriented paper products are reported to be either down from a year ago or starting to show weaker growth. Sales of residential plumbing and temperature control equipment continue to do well, but are expected to decrease two to three quarters out. Demand continues to grow strongly for aircraft, health and fitness, energy-saving, and security-related products and equipment. One respondent reports benefiting from rising defense expenditures, but a couple of other companies indicate that the current defense spending mix is hurting their company's sales. Most manufacturing contacts project that their inventory levels will hold steady or decrease slightly through the end of the year.

Most respondents indicate that they are continuing to experience increases in input costs. Contacts point to energy and transportation, metals, paper, and chemicals as sources of cost pressure. A couple of firms mention that steel prices have risen less than they had anticipated, while another describes steel prices as being "on a rollercoaster." Virtually all companies with higher materials and energy costs are raising their selling prices to some extent. On the whole, they report being able to pass along a greater share of cost increases to industrial and commercial than to retail customers.

Most manufacturers report that their U.S. headcounts are stable or increasing slightly. Base pay increases typically remain in the range of 3 to 4 percent. However, tight markets for finance, information technology, engineering, and scientific personnel are leading to an acceleration in salary increases, large signing bonuses, or higher turnover. Domestic capital spending plans for 2006 are mixed, but more manufacturers expect to increase than decrease their expenditures compared to a year earlier.

Contacts are tending to adopt a "more of the same" stance with respect to business projections for late 2006 and early 2007. Even though some respondents cite risks associated with deteriorating demand for their products, the prevailing attitude seems to be that any surprises are likely to be manageable.

Software and Information Technology Services

Business appears to be growing steadily at software and IT services companies in the First District, with the majority of firms reporting double digit year-over-year revenue increases in the most recent quarter. Contacts state that the market is competitive, so most have kept prices unchanged.

Contacted companies are adding technology workers and sales staff, with companies serving the healthcare sector indicating they are hiring aggressively in order to keep pace with demand. All responding firms with plans to hire report tightening in the labor market, especially for specialized technical positions; several firms note that they feel some upward wage pressures for those positions. Respondents report annual wage increases for most employees between 3 percent and 7 percent, while wages for highly-skilled technical positions are up by as much as 15 percent. Several software and IT services contacts indicate they are increasing capital and technology spending to expand facilities and upgrade equipment.

First District software and information technology firms expect steady growth for their companies in the second half of the year, with the exception of firms serving the manufacturing sector, who say they expect demand to decline.

Staffing Services

Reports on business conditions in the New England staffing industry are mixed this quarter, with the only unifying theme among contacts being that things are not going as expected. Firms that are usually very busy in the summer months have had a weak quarter through mid-August, while firms that typically have a slow third quarter have been experiencing high growth rates.

For one Connecticut firm, "this has certainly not been a banner year;" the firm lost money during the first half of the year and only recently started to see a slight turnaround. Another contact reports, "Nobody's booming ï¿½everybody's hustling. Things are off a bit." By contrast, an information technology staffing firm is experiencing year-over-year revenue growth between 25 percent and 30 percent, while a professional and technical staffing firm reports that its billing and cash receipts are up almost 100 percent from a year ago. Currently, demand for labor is strongest in the information technology, financial, and healthcare sectors. Some respondents still report that tight labor supply in these areas is forcing them to increase their expenditures on recruiting and is putting pressure on wages. When asked about their expectations for the remainder of the year, contacts are ambiguous. Overall, however, respondents reporting growth expect more of the same, while those reporting poor results express uncertainty.

Commercial Real Estate

Centrally located office space across New England continues to perform well. Boston's core business district office availability (vacancies plus sublease) has improved slightly but remains between 12 percent and 13 percent. Rents are stable or up across the region, with premium office space in Boston priced at around $50 per square foot. Contacts still say the job creation is critical to the health of specific markets. Enhanced job creation in smaller downtowns, such as Providence, is driving growth. Conversely, contacts view Boston's current slow rate of job creation as potentially hampering future vacancy reductions.

Commercial real estate investment continues to rise in New England. One contact suggests that in Boston, increasingly aggressive underwriting assumptions for commercial real estate transactions—high future occupancy, low capital expenditure and significant future rent increases—are justifying higher commercial real estate prices. Correspondingly, commercial real estate yields based on current market conditions have been further compressed. Contacts believe that the amount of commercial real estate investment in New England will continue to grow. Belying the investment assumptions, however, respondents suggest that office vacancies and rents may remain primarily stable over the next quarter.

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Second District--New York

Economic activity in the Second District has shown signs of decelerating since the last report, though business contacts generally report that the labor market remains steady and strong. Manufacturers report widespread increases in input prices; they also note further deceleration in business activity and are a bit less optimistic about the near-term outlook. Retailers indicate that sales were on or close to plan in August, while prices were relatively flat. Tourism activity was mixed around generally robust levels: New York City hotels continue to report strong revenue growth, but Broadway theaters report that attendance, though still high, retreated in July and August.

Both new home construction and the home purchase market continued to slacken in July and August, but Manhattan's apartment rental market reportedly strengthened further. Office markets across the New York City metro area were steady to stronger in July and August while the market for industrial space was mixed. Activity in the securities industry activity is reported to have weakened across the board in July and August. Finally, bankers again report widespread slackening in loan demand, somewhat tighter credit standards, and little change in delinquency rates.

Consumer Spending

Retailers report that sales were on or slightly below plan in the first three weeks of August, with gains in same-store sales ranging from 1 to 5 percent, compared with a year ago. Retail contacts note that premium merchandise continues to sell better than lower-end lines but that furniture and other home goods continue to lag other merchandise categories. Retailers report that selling prices remain steady; inventories are said to be at favorable levels, though one large chain reports some shortages of high-end merchandise, which may have hindered sales slightly.

Tourism activity has been mixed but generally at a robust level since the last report. Manhattan hotels report that business was strong in July, which is usually a relatively slow month; occupancy rates remained in the high 80s—virtually unchanged from a year ago—while room rates were up 9 percent from a year earlier. In contrast, Broadway theaters report that business weakened moderately in July and the first three weeks of August; attendance was down roughly 7 percent from a year earlier, while total revenue was up less than 3 percent.

Construction and Real Estate

The region's housing market has slackened further since the last report, with the notable exception of Manhattan's rental market. Housing permits have weakened markedly in recent months, with July particularly soft. Based on the first seven months of the year, single-family permits in the New York-New Jersey region are on track for their weakest year since 1996. Multi-family permits, though down in recent months, remain at relatively high levels. More currently, New Jersey homebuilders report that the inventory of homes on the market continued to increase in August, and that market psychology has worsened. Builders have begun advertising price reductions on new properties instead of merely offering concessions. Nonetheless, an industry expert notes an increasingly large gap between asking prices and offers, which has caused inventories to swell.

Manhattan's co-op and condo market slowed further in July and early August. The inventory of homes on the market is reported to have risen noticeably, and units are staying on the market for longer. Both the number of transactions and total sales volume were down from a year earlier in August; the high end continues to be the most active market. At the same time, Manhattan's rental market was characterized as increasingly robust in July and August, across the board, but especially at the high end of the market. The inventory of available units has continued to shrink, rents are up, and prospective renters are signing leases more quickly than in the recent past.

Commercial real estate markets across the New York City area have been steady to stronger since the last report. Between the end of June and late August, office vacancy rates declined and asking rent increased considerably in New York City, Fairfield County, Westchester County, and Long Island. In Northern New Jersey, however, vacancy rates edged up while rents were little changed. Similarly, industrial vacancy rates fell in Long Island, Westchester, and Fairfield Counties, but rose to a more than ten-year high in northern New Jersey.

Other Business Activity

A securities industry contact reports a broad-based weakening in conditions since mid-year. Activity in capital markets has turned down in both primary and secondary markets--all major areas of issuance have weakened: debt, equity, derivatives. Trading revenue has also tapered off. A major New York City employment agency, specializing in office jobs, reports that there has been no discernible change in the job market since the last report, though August is a quiet month and difficult to use as a gauge. More broadly, non-manufacturing firms in the District report they have stepped up hiring activity in August, despite some reported slowing in overall business activity.

Based on our August Empire State Manufacturing Survey, respondents report further deceleration in business activity and continued widespread increases in input prices but only limited increases in selling prices. Manufacturers remain optimistic about the near-term outlook, though less so than in July.

Financial Developments

Small to medium-sized banks in the Second District report decreased demand for all types of loans since the last report—most notably in the commercial and industrial loan category, where 35 percent of bankers report a decrease and 18 percent report an increase. Ongoing widespread declines are also reported in refinancing activity.

Bankers report tightened credit standards for all loan categories except residential mortgages, where standards remained unchanged. In contrast, more than one in five bankers reports tightened credit standards for commercial mortgages, while no bankers report eased standards. Bankers report continued widespread increases in both deposit rates and loan rates across all categories. Delinquency rates were little changed across all loan categories, though a slight increase was reported for residential mortgages.

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Third District--Philadelphia

Economic activity in the Third District increased in August, although the rate of growth appeared to ease. Manufacturers' shipments and orders increased. Retail sales of general merchandise rose slightly, but auto sales weakened. Bank lending increased, but not as much as it had in previous months. Residential real estate activity slowed sharply, but commercial real estate markets tightened.

Third District business contacts generally expect business activity in the region to continue to expand, but they have become more cautious in their outlook. Manufacturers expect further gains. Retailers anticipate only modest growth in sales. Auto dealers expect sales to remain slow. Banks anticipate slight gains in business and consumer lending but forecast a further decline in mortgage lending. Commercial real estate contacts expect the demand for office and industrial space to continue, but residential real estate agents and home builders anticipate further declines in home sales.

Manufacturing

Business activity picked up in August for manufacturing firms in the region. Around a third of the Third District manufacturing companies contacted for this report said that shipments and new orders rose during the month, twice as many as reported declines. Demand increased in August for metals, industrial materials, and wood products but slipped for transportation equipment and apparel. On balance, area manufacturers reported steady order backlogs and delivery times in August.

Overall, manufacturers expect demand for their products to continue moving up at about the current rate of growth. About 40 percent of the firms contacted in August expect their shipments and orders to increase during the next six months; about 20 percent expect decreases. Capital spending plans reported by Third District manufacturers in August were less robust than they were in previous months. On balance, manufacturers have scheduled only marginal increases in outlays for new plant and equipment during the next six months.

Retail

Most of the retailers contacted for this report indicated that sales rose in August, but only slightly compared with August of last year. The back-to-school sales period has not been as strong as many retailers expected. Apparel sales, in particular, have been softer than anticipated. Store executives indicated that discounting has been widespread. Looking ahead, area retailers have subdued forecasts. They believe consumer confidence has weakened, and they expect consumers to limit discretionary spending in the months ahead.

Auto sales in the region slowed in August, and dealer inventories increased. Domestic manufacturers have stepped up incentives to clear out 2006 models before delivery of 2007 models, but most area dealers do not anticipate an upturn in sales.

Finance

The volume of loans outstanding at Third District banks rose slightly in August, according to commercial bank lending officers contacted for this report. Commercial and industrial lending increased for most banks. Credit card lending expanded, but other types of personal lending slowed. Demand for residential mortgages eased. While overall credit quality was good, according to bankers contacted for this report, some noted increased delinquencies on residential mortgages.

Bankers in the District expect business and consumer lending to increase in the months ahead, but not strongly. They also expect gains in credit card lending. However, they anticipate a further decline in demand for residential mortgages.

Real Estate and Construction

Commercial real estate firms reported that vacancy rates in the region's office markets have continued to decline in the past few months, and rents have risen. There has been an increase in both speculative and build-to-suit construction of office buildings. Commercial real estate contacts expect a further tightening of the region's office markets this year if the local economy continues to expand. Demand for industrial space in the region continued to grow, and supply has been limited as older buildings have been taken off the market for conversion to non-industrial uses. The limited supply has encouraged an increase in the construction of industrial buildings on both a speculative and build-to-suit basis.

Residential real estate agents and homebuilders reported a sharp slowdown in sales in July and August, compared with the spring months and with July and August of last year. Real estate contacts noted that the number of existing homes for sale and the time they are on the market have been increasing. Price appreciation of existing homes has slowed or stalled in many areas. For new homes, builders are offering more features without charge. Homebuilders and real estate agents expect the pace of sales to slow further during the rest of the year.

Prices and Wages

Business firms in the Third District reported continuing increases in the costs of raw materials and intermediate goods. Manufacturers noted recent increases in prices for metals, petroleum-based products, and energy. Construction firms reported increases in prices for metal products, drywall, and vinyl and plastic products. However, retailers generally indicated that selling prices are not on the rise, and that discounting has been extensive during the back-to-school shopping period.

Employers in many industries reported that labor markets remain tight for both skilled and unskilled workers. In service industries, firms report rising turnover among information technology, finance, and managerial occupations. In contrast, some residential construction companies have laid off workers as demand for new homes has declined. Wages are generally reported to be rising slightly faster now than at this time last year, but salaries offered for positions that are difficult to fill have increased substantially. Firms in all industries continue to report increases in health care costs.

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Fourth District--Cleveland

The District's economy showed modest growth in July and early August, but growth was mixed and the outlook less certain due a continuing slowdown in auto production and residential construction. Most District manufacturing contacts reported steady production in the six weeks ending in mid August, although their outlook has dimmed somewhat. Retailers experienced mixed sales activity with high gasoline prices most often cited as the reason for any declines. Commercial builders reported strong backlogs and an increase in customer inquiries, while new home sales continued to be weak. Commercial and consumer borrowing was generally characterized as steady. And the strong demand for trucking and shipping services seen for the past year has begun to moderate.

On net, hiring across the District was steady. Staffing firms reported job openings in Ohio and Pennsylvania continued to moderately increase with demand coming from the professional business services, healthcare, and defense sectors. Wage pressures were not seen as an issue at this time. Although many contacts reported increased input costs related to petroleum, metals, and healthcare, several noted that the rate of increase seems to be slowing. Most manufacturers attempted to pass these costs along to their customers with a mixed degree of success. Retailers generally reported holding their prices steady.

Manufacturing

Since mid July the District's durable goods manufacturers reported steady production, at levels above those of this time last year. Steel producers characterized demand as good (if weaker than earlier in the year) with strong growth in stainless steel among capital goods and appliance manufacturers and customers in the chemical and energy business. District auto production weakened over the last six weeks as well as on a year-over-year basis. Some of the decline is attributed to a seasonal lull, but production levels for the next six months are anticipated to be below those reported for the first half of 2006. The overall outlook for manufacturing is mixed with slowing demand in the auto and housing industries and continued strength in capital goods. Although most contacts reported very little or no idle capacity, few durable goods manufacturers are expanding their capital spending plans. Only about half the producers contacted said they were able to successfully pass on increased costs for energy and metals through higher prices. Hiring has been relatively flat; however, fewer contacts than earlier in the year anticipate much hiring in the near future. Wage pressure remained limited.

Production at the District's nondurable goods facilities has been steady since mid July with mixed results on a year-over-year basis. Expectations for the next six months are also mixed. Most producers reported idle capacity and only a few planned to increase their investment spending. None of the contacts reported increasing employment in the past six weeks and only two said they plan to hire in the near future.

Retail

Sales by District retail contacts were mixed since mid July with most citing high gasoline prices as having an impact on disposable income. Apparel retailers reported their sales were flat to declining; however, sales were close to expectations. Grocery stores saw modest gains while drug stores reported very strong sales especially from prescriptions, cosmetics, and convenience foods. Finally, some restaurant owners experienced a large drop in customers citing high gas prices as the reason.

Several contacts noted their costs are rising due primarily to energy prices and healthcare expenses, although several also said that the rate of increase in healthcare expenses has slowed; nevertheless, product prices were holding steady to showing only modest increases. Most retailers noted no unusual hiring plans.

New car sales were mixed with foreign plates generally doing better than domestics. On a year-over-year basis car sales are down significantly due to the success of last year's employee pricing program. SUV sales also showed a dramatic decline with dealers blaming consistently high gas prices.

Construction

New home sales continue to be weak with 80 percent of contractors reporting softer sales on a year-over-year basis. A number of builders have curtailed or stopped speculative home building and continue to offer discounts as a means of enticing buyers. Most contacts expect sales to remain soft for the remainder of the year with 2006 totals to be below those in 2005. Almost all homebuilders report material costs have increased but not significantly. Many noted increases in electrical and plumbing supplies due to increased copper prices while about half saw a decrease in lumber costs. Three of the larger builders laid off workers over the past several months; otherwise, direct employment was relatively unchanged.

The District's commercial contractors all reported an increase in business on a year-over-year basis and that customer inquiries were up since mid-July. The majority of builders also reported strong backlogs. Among the segments where sales remained robust were health care and manufacturing. Retail (specifically foreign-nameplate auto dealerships) and municipal utilities saw a pickup in construction activity. Material costs reportedly continued to rise across the board. Copper and petroleum-related products increased significantly while more modest increases were reported for steel and concrete. Most builders can pass these price increases through to their new customers, but aren't able to adjust existing contracts. Contractors reported little change in the size of their labor force.

Banking

At District banks, both commercial and consumer borrowing remained steady or was slowing since early July. Auto loan demand was characterized by all contacts as being soft. The mortgage market has contracted due to recent increases in interest rates and an excessive inventory of unsold houses. Most mortgage activity was due to refinancing as consumers moved from ARMs to fixed rate mortgages. While credit quality remains strong, most bankers reported a slight increase in delinquencies which they attributed to a few large commercial accounts. Finally, nearly all contacts reported a gain in core deposits driven primarily by commercial activity.

Transportation

Demand for trucking and shipping services has moderated since mid July with a slight decrease in volume of freight on a year-over-year basis. High fuel costs remain a concern with trucking companies continuing to pass on these costs to end-users using surcharges. However, there are scattered reports of customers wanting to negotiate down the surcharge. An upward movement in wages was reported by a majority of the contacts. Reasons cited include a driver shortage and labor contracts.

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Fifth District--Richmond

Economic activity in the Fifth District continued to grow at a slow pace since our last report, with the performance of individual sectors mixed. Manufacturing activity posted modest growth, with new orders increasing somewhat and shipments declining slightly. Retailers said that while overall sales remained sluggish, big-ticket sales weakened further. Services firms generally reported moderately faster growth in revenues. Housing markets cooled further in most, but not all, localities. While current commercial real estate activity was spotty, there were hints of firming demand. District labor markets remained solid, with businesses hiring and spot reports of skilled-worker shortages continuing. Prices generally increased modestly, and contacts noted some pullbacks in energy and building materials prices. In addition, businesses indicated that it was more difficult to pass higher input prices through to customers. In agriculture, hot and dry conditions stressed crops and led to concerns about water supplies in some areas.

Retail

District retailers reported generally sluggish retail sales, with continued weakness in big ticket sales offsetting steady activity in other categories. On a positive note, a sales tax holiday boosted back-to-school sales in Virginia. However, a big-box retail contact indicated that higher gasoline prices continued to cut into the budget of many of his customers, contributing to a small decline in same-store sales. Sales were lower at a building supply chain as housing construction cooled. Car and light truck sales were generally softer. An automobile dealer in northeastern West Virginia said that buyers have become more cautious and that he had reduced his inventory in line with lower sales expectations. Retail employment was unchanged among many of our contacts, although some department stores increased their ratio of regular part-time to full-time workers. Retail price growth edged up slightly, though not in all categories. A contact in the Washington, D.C., area said that a falloff in new residential construction lowered prices of lumber and plywood in recent weeks.

Services

Revenue growth at service-producing firms generally picked up in recent weeks. Despite recently heightened security concerns, airports reported that their revenues grew more quickly. Air conditioning contractors also noted strong demand for their services as temperatures remained above normal. Contacts at several District hospitals and healthcare systems reported solid consumer demand, but said they are bracing for an expected round of reimbursement cuts from Medicare. In contrast, architects said their billings flattened as the market for new homes slowed. The pace of hiring in the services sector stepped up, while services price growth moderated since our last report.

Manufacturing

Manufacturing activity expanded at a slower pace since our last report. Manufacturers told us that shipments declined, while new orders increased modestly and employment moved higher. Among industries, producers of apparel, fabricated metals, food, furniture, and lumber exceeded the declines in output from mid July through late August. A machinery manufacturer in North Carolina reported stronger orders, though a residential door producer in the state said that his orders had softened. A number of respondents indicated that while raw materials prices were increasing less rapidly, they could no longer pass through those increases.

Finance

District bankers reported little change in lending activity since our last report. Contacts said that commercial lending was flat. A Charlotte, N.C., banker suggested that the demand for commercial loans may have peaked, and could begin to slow. Lenders reported that they have to work extra hard for business. "We've had to beat the bushes just to get what [business] we're getting," said one contact. Bankers across the District noted that mortgage lending also continued to be soft. However, some contacts noted an increase in refinancing activity, with some customers switching from variable rate loans to fixed rate loans to protect against future interest rate increases.

Real Estate

Residential real estate agents reported additional signs of cooling in many District housing markets. In Asheville and Charlotte, N.C., agents told us that some clients moving into their areas were unable to complete home purchases there because they could not sell their existing homes located in other parts of the country. A Washington, D.C., agent reported "incredibly slow" sales, especially for new construction and condominiums, adding that his inventory had more than doubled from year-ago levels. But not all markets were slower. A Realtor in Greenville, S.C., reported that area sales were up 14 percent over year-ago levels. In addition, contacts in Richmond, Va., and in Greensboro, N.C., told us that while August was typically slow due to schools starting, their housing markets remained busy. In many markets across the District, home prices declined modestly. But a Richmond, Va., Realtor reported some price appreciation in mid range homes, although he added that there was a "dramatic slowdown" in the prices of higher bracket homes. In addition, an agent in Asheville, N.C., reported steadily rising home prices, with increases of 10 to 12 percent over year-ago levels.

Commercial real estate agents across the District reported little overall change in leasing activity since our last report. An agent in Manassas, Va., for example, noted that while office leasing had slowed significantly, retail and industrial leasing continued to be very strong due to rapid population growth of the area. Agents noted that commercial rental rates appear to be firming. A Raleigh, N.C., agent said that "it is still a tenant's market, but it is becoming increasingly better for the landlord." Little change was reported in vacancy rates and new construction activity.

Tourism

Tourist activity was generally mixed in August. Contacts along the coast generally reported former bookings since our last report, helped by good weather and increased short-term stays. In addition, a manager at a mountain resort in Virginia said that time-share sales were doing extremely well--up 20 percent over last year. In contrast, a counterpart in West Virginia indicated somewhat weaker bookings compared to a year ago, which she attributed in part to higher gasoline prices.

Temporary Employment

Temporary employment agents reported generally strong demand for workers since our last report. In Richmond, Va., an agent was optimistic that demand would remain solid as companies were increasingly relying on temporary workers. An agent in Raleigh, N.C., reported ongoing demand for full-time workers, but added that skilled workers remained hard to find. In contrast, some softening in demand for temporary workers was reported by an agent in the Washington, D.C., area. Employees with skills in computers, sales, production, warehouse, and life sciences were highly sought by employers. Increasingly, employers also were looking for bilingual employees.

Agriculture

Hot, dry weather in late July and August depleted soil moisture and hindered crop development in many areas of the District. Excessive heat and dry field conditions in Maryland and Virginia stressed soybeans and hindered corn development. In those areas, pasture conditions also deteriorated. Moreover, farmers in Virginia were concerned about adequate water supplies for their livestock. In contrast, cattle herds and pastures were reported to be in mostly good condition in West Virginia. Despite hot and dry weather, corn and soybeans progressed well in North Carolina, and the peach harvest was ahead of schedule in South Carolina.

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Sixth District--Atlanta

Reports from Sixth District contacts indicated that business activity was mixed from mid-July through August. Retail sales exceeded expectations while auto sales were down overall from a year ago. Home sales and new residential construction continued to weaken in many areas, with Florida markets reporting the largest declines. In contrast, the pace of nonresidential construction improved slightly. Also, reports from manufacturers, transportation firms, and tourist industry contacts were generally upbeat. Banking contacts noted lower residential loan demand and little change in the demand for commercial and industrial loans. Contacts reported that labor shortages in the construction industry persisted in many parts of the District, while localized shortages were noted in some other industries, including the Gulf Coast hospitality industry. Continuing cost pressures related to energy inputs were reported by most businesses, whereas the ability to pass along these higher costs to consumers remained limited.

Consumer Spending

District retailers reported that sales during late July and August exceeded expectations and were slightly above year-ago levels. Nonetheless, inventories were described as balanced by most contacts. The reports from mid- and high-end retailers continued to be stronger than those from lower-end and discount retailers. The recent sales tax holidays boosted retail sales in Alabama, Florida, Georgia, and Tennessee. The outlook among retailers remains positive, with most expecting increased sales over the next three months compared with a year ago.

Vehicle sales continued to be mixed. Domestic brand dealers reported sluggish traffic and undesirably high inventories. Dealers handling foreign brands noted improved volumes from a year earlier, although some had offered incentives to clear inventories of less fuel-efficient 2006 models.

Real Estate

Residential housing markets continued to pull back in late July and August in most areas of the District. Both Realtors and homebuilders indicated that single family housing inventories rose compared to the prior month and from a year ago. The most significant sales declines continued to be noted in Florida markets, although the pace of decline moderated in some markets there. Within the multi-family segment, condominium markets in Florida remained especially weak. At the same time, Atlanta has experienced a surge in condominium construction. The outlook among real estate agents and builders was for more weakening over the next several months. The limited availability and higher price of property insurance was said to be adversely impacting housing and commercial real estate demand in coastal markets. By some accounts, premiums in parts of Florida have quadrupled from a year earlier.

Reports from commercial builders indicated that nonresidential construction in the District was slightly stronger than a year earlier. Modest improvements were noted in the industrial and office sectors as vacancy rates declined in several markets. Contacts in Florida noted that condominium developers and contractors were now turning to the non-residential market for new business. Most reports anticipated continued modest increases in activity over the next several months.

Manufacturing and Transportation

Manufacturing activity was mostly positive according to reports. Several building materials producers continued to report strong demand and high production levels. A manufacturer of electrical equipment was operating at near capacity and reported increasing order backlogs and capital expenditures. Some vehicle assembly and parts manufacturers reported planned expansions, and several defense contractors have been awarded large military contracts. Less positively, a furniture manufacturer announced the closing of a large facility, and weaker demand for recreational boats led to production cutbacks by a major boat producer. Reports from freight transportation contacts remained upbeat as the demand for trucking services was strong, and airborne shipments through Atlanta were above year-ago levels.

Tourism and Business Travel

Reports from the tourism sector were generally positive in late July and August. A central Florida theme park noted that attendance in July was above that of a year ago, while resort tax collections and passenger numbers through Orlando International Airport also rose. Gaming revenues were the strongest since Hurricane Katrina at Mississippi Gulf Coast casinos. In addition, reports suggest that cruise ship traffic through New Orleans is expected to return to pre-Katrina levels by next year. Attendance at the new aquarium in Atlanta far outstripped expectations and has generated strong room demand at nearby hotels.

Banking and Finance

Banking conditions in the District were characterized by further declines in demand for real estate loans and little change in commercial and industrial loan demand. Several contacts suggested that higher property insurance premiums in Florida had dampened real estate loan demand. Most contacts noted increased competition for deposits. Credit quality indicators remained strong.

Employment and Prices

Contacts continued to report labor shortages in some industries and locations. Staffing the re-opened casinos along Mississippi's Gulf Coast remained a problem for casino operators because of the lack of housing, and hospitality workers remained in short supply in New Orleans. Builders noted a shortage of qualified workers in many parts of the District with the

most acute shortages reported along the Mississippi Gulf Coast.

Most businesses reported continuing costs pressures because of high energy prices, with only limited success in passing higher costs on to consumers. Many firms had adjusted to increased costs by cutting profit margins or reducing staff and service levels. However, one steel manufacturer reported that further cost cuts were no longer possible without affecting efficiency and productivity. Residential and commercial construction contacts noted increasing material and labor costs, especially along the Mississippi Gulf Coast.

Agriculture and Natural Resources
Most District crops and pastures continued to suffer from excessively dry weather conditions in July and August. Soil moisture were said to be alarmingly short in areas of Alabama, Florida, Georgia, and Mississippi. Conditions for the cotton and peanut crops in Alabama and Georgia were described as between poor and very poor by the USDA. Poultry producers continued to experience lower prices because of weaker export demand related to fears of the Avian Influenza.

Interest in energy exploration in the Gulf of Mexico has intensified with the total value of bids for federal oil and gas leases in the Gulf up 38 percent from August of last year.

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Seventh District--Chicago

Economic activity in the Seventh District expanded at a moderate pace during July and early August, with most reports suggesting a similar pace of expansion as in the previous reporting period. Consumer spending continued to increase modestly, and business spending expanded again. Overall labor market conditions were little changed, with small gains in employment on net. Residential construction and real estate activity declined again in most areas, while the pace of new commercial construction continued to be solid. Manufacturing activity remained strong. Mortgage lending declined, while commercial lending expanded, albeit at a slightly slower pace than in the previous reporting period. Nonlabor input cost pressures remained firm in July and early August, and there were reports of stronger pressures on retail prices and wages. Corn and soybean conditions improved as above-average precipitation reduced the area of the District affected by drought. Expectations were for a "good, but not great," harvest.

Consumer Spending
Consumer spending continued to increase modestly in July. Retailers in Illinois and Iowa said sales growth was a bit faster than in June, while a credit card processing service for Michigan retailers said results were "very weak." High gasoline prices reportedly dampened spending again in the District, both by squeezing budgets and by leading shoppers to make fewer trips to the store. Retail inventories were at desired levels. Promotions generally followed the typical seasonal patterns; however, some retailers expanded back-to-school promotions to include other products, notably consumer electronics. Auto dealers reported that sales have picked up in the past six to eight weeks, led by demand for higher-gas-mileage vehicles. New vehicle inventories were said to be above desired levels. A large restaurant chain said that sales in the Midwest were up slightly from last year, but gains in the Midwest were weaker than in other regions. Tourism in Michigan was running below a year ago, though some contacts suggested that it had picked up in recent weeks.

Business Spending
Business spending and hiring expanded again in the District. For the most part, capital spending continued to increase at similar rates as in the previous reporting period. A banker noted that the increases in their lending to firms in the District were consistent with a modest rise in capital expenditures. Overall labor market conditions were little changed, with small gains in employment on net. Factory employment ticked up, led by growth at toolmakers, while employment at retailers, hotels, and banks was little changed. A local internet job posting business said that growth in listings remained positive and it had seen no signs of slowing. Shortages of skilled manufacturing workers persisted, and there were continued reports of difficulty in filling engineering job openings. A temporary help services provider said that demand growth in the District moderated; while orders from large firms remained steady, demand from smaller businesses was softer.

Construction and Real Estate
Residential construction and real estate activity declined again in most areas. Homebuilders noted that the slowdown cut across all segments of the market, though some contacts pointed to the high-end market as particularly sluggish. Nonetheless, builders in Michigan said that the rate of the decline had tapered off some, and builders in Wisconsin said they were "pleasantly surprised" with traffic through model homes. With regard to future activity, contacts in southeast Michigan noted that some development projects had been cancelled recently and that other developers are delaying new construction as they wait for existing inventories to sell. Contractors in Wisconsin were said to be requiring larger upfront payments to ensure that their projects are not cancelled. The pace of new commercial construction continued to be solid. Contacts in several areas noted that the commercial segment has been "pretty resilient." A developer in the Chicago area said that net absorption of office space continued at high rates. However, a contractor in suburban Milwaukee reported that they were working off backlogs faster than expected.

Manufacturing
Manufacturing activity remained strong during July and early August. Sales of heavy equipment continued to be solid, led by demand from the mining and energy sectors. Some mining equipment was said to be sold out through 2008. Orders for construction equipment related to nonresidential projects remained solid, and one analyst predicted only a slight moderation in growth for next year. Farm tractor sales were down slightly from a year ago. Heavy-duty truck production continued to be strong, though contacts were expressing concern about what will happen to demand in 2007 when stricter emission standards are in place. Toolmakers reported strong order growth; tool production was running at high capacity utilization rates, and overtime was up at some facilities. Steel producers reported strong demand growth from most markets, though some softening was expected. Inventories at steel service centers increased and were slightly above desired levels. A wallboard producer said shipments softened in recent weeks, but production continued at high rates. Appliance shipments continued to slow.

Banking and Finance
Lending activity moderated further. Bankers noted further declines in mortgage applications for purchases, though refinancing perked up as customers looked to lock in low fixed-rate mortgages. One contact said that demand for home-equity loans continued to decline because homeowners were seeing less home price appreciation. Household credit quality remained in good shape with stable delinquency rates. Commercial lending continued to expand, but at a slightly slower pace than in the previous reporting period. One banker noted that business lending in the District lagged behind other parts of the country. Leasing activity picked up at a Chicago-area bank. Commercial lending conditions continued to be competitive and interest rate margins were narrow. Commercial credit quality remained in good shape, and some metrics even improved.

Prices and Costs
Nonlabor input cost pressures remained firm in July and early August, and there were reports of stronger pressures on retail prices and wages. Almost all contacts reported higher energy costs. One manufacturer said that they and their suppliers were "irritated" that energy costs had not eased yet, and a retailer said that higher energy costs have now become fully factored into their cost structure as their long-term contracts had expired during the past three to six months. Other materials prices were increasing as well, including copper, concrete, and wallboard; but lumber and scrap steel prices declined. Price increases at the consumer level were modest, though a mid-sized retailer in Iowa said they had improved their margins despite higher cost pressures. Apartment rents in Illinois increased, and a contact in Wisconsin said landlords had increased flexibility to raise rents. Wage pressures picked up overall, most notably in professional and technical positions.

Agriculture
Above-normal rains fell in late July and August, which reduced the area of the District classified as under drought conditions to the western edge. Corn and soybean conditions improved since the last reporting period, despite a July heat wave. Expectations for the corn and soybean harvest were revised up, leading to lower crop prices than in the previous reporting period. Overall, reports suggested that corn and soybean yields will be "good, but not great," in the District. Farmers and elevators expanded storage capacity based on expectations for higher corn prices next year. Notably, the pace of ethanol expansion has boosted forecasts of the demand for corn and raised concerns about long-term cost pressures on competing uses of corn, particularly feed. Hog and cattle prices continued to rise.

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Eighth District--St. Louis

The economy of the Eighth District expanded modestly since our previous report. Contacts reported improved conditions in manufacturing and continuing growth in the services sector. More contacts in the retail and auto sectors reported decreasing sales in July and August relative to a year ago than reported increasing sales. Reports from contacts in both residential and commercial real estate markets varied across the District. Lending activity at a sample of District banks experienced little change in the three-month period ending in July.

Consumer Spending
Contacts reported that retail sales in July and August were down, on average, over year-earlier levels. About half of the retailers surveyed saw a decrease in sales, while another 38 percent saw an increase. Half of the retailers noted that sales levels met their expectations, 35 percent reported that sales were below what they had anticipated, and 15 percent reported sales above expectations. Summer weather items, apparel, and school supplies were all strong sellers, while furniture and non-essential items were moving more slowly. Approximately 59 percent of the contacts noted that inventories were at desired levels; 27 percent reported that inventories were too high, and 14 percent reported that inventories were too low. About 46 percent of contacts expect that sales will increase in September and October over 2005 levels, while 29 percent expect decreased sales.

Car dealers in the District reported that sales in July and August were down, on average, over year-earlier levels. About 54 percent of the car dealers surveyed reported a decrease in sales, while 35 percent reported an increase. About 31 percent of the car dealers noted that used car sales had increased relative to new car sales, while 8 percent reported the opposite. Also, 31 percent reported an increase in low-end vehicle sales relative to high-end vehicle sales. About 19 percent of the contacts reported higher rejection rates of finance applications, while 12 percent reported more acceptances. Nearly 35 percent of the car dealers surveyed reported that their inventories were too high, while 31 percent reported that their inventories were too low. About half of the car dealers expect that sales will increase in September and October over 2005 levels, while 31 percent expect decreased sales.

Manufacturing and Other Business Activity
Manufacturing activity expanded at a moderate pace. Several manufacturers announced plans to expand operations, open new facilities, or hire additional workers, and a smaller number of firms announced plans to close plants and lay off workers. Firms in the transportation equipment, fabricated metal product, plastics, and auto parts industries announced plans to open or expand facilities in the District. Contacts in the wood product, aerospace, and electrical equipment industries reported plans to hire additional workers and expand operations. In contrast, firms in the motor vehicle, food, and primary metal product industries reported plans to lay off or temporarily idle workers in the District.

The District's services sector continued to expand in most areas. Contacts in the freight transportation and business support services industries announced plans to open new facilities in the District. Contacts in the leisure and hospitality sectors hired additional workers. In contrast, contacts in the health services and air transportation industries reported plans to lay off workers.

Real Estate and Construction
July year-to-date home sales were mixed throughout the Eighth District. Home sales increased 13 percent in Memphis and 4 percent in Louisville compared with the same period in 2005. In contrast, July year-to-date home sales declined by 3 percent in Little Rock and remained virtually unchanged in St. Louis. Residential construction continued to weaken throughout most of the District. June year-to-date single-family residential permits declined in most areas. Compared with the same period last year, permits declined nearly 40 percent in Louisville, 17 percent in St. Louis, 8 percent in Little Rock, and 6 percent in Memphis. Permits, however, were up 26 percent in Jackson, Tennessee, and 25 percent in the Fayetteville, Arkansas, metro area.

Commercial real estate market conditions throughout the District were mixed. The second quarter 2006 industrial vacancy rate in St. Louis and Memphis remained unchanged from that of the first quarter, while the industrial vacancy rate in Louisville declined. During the same period, the office vacancy rate declined in St. Louis and Memphis, but increased slightly in Louisville. Contacts in the Louisville region report more stability and optimism regarding commercial construction than in the beginning of 2006; they note that light commercial construction is declining. Contacts in St. Louis report that industrial development remains strong.

Banking and Finance
A survey of senior loan officers at a sample of District banks showed little change in overall lending activity in the three months ending in July. In this period, credit standards and demand for commercial and industrial loans remained basically unchanged for both large and small firms. During the same period, credit standards for commercial real estate loans varied from unchanged to slightly tightened, while demand for these loans remained unchanged. Credit standards for residential mortgage and consumer loans were generally unchanged. Demand for residential mortgage loans remained unchanged, while demand for consumer loans was moderately weaker.

Agriculture and Natural Resources
Because of recent dry and hot weather in the District, crop and pasture conditions have deteriorated slightly. Sixteen percent or less of the corn, soybean, rice, sorghum, and cotton crops are rated in poor condition. Yields for most crops this year are expected to be on par with last year or better in the District states; corn and soybean yields in Mississippi, however, are expected to be 22 percent lower than last year.

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Ninth District--Minneapolis

The Ninth District economy grew modestly since the last report. Increases in activity were noted in consumer spending, commercial real estate and construction, manufacturing, mining, and energy. Meanwhile, tourism, agriculture, construction, and residential real estate and construction activity decreased. Since the last report, employment increased and wage growth accelerated slightly. Significant price increases were noted for some building and energy products.

Consumer Spending and Tourism
Overall consumer spending was up slightly. A North Dakota mall manager noted that back-to-school sales were solid. Another mall manager in North Dakota noted that sales were up about 1 percent in July compared with a year ago, while activity in early August was down slightly. A major Minneapolis-based retailer reported same-store sales up 3 percent in July compared with a year ago. Recent traffic at a Montana mall was up 3 percent from a year ago, while sales were up 6 percent.

A representative of an auto dealers association in Montana noted that overall recent sales were down for new vehicles, while the used-car market was as strong as last year. Truck and SUV sales were down, while sales of more fuel-efficient vehicles were up. An auto dealer in the Minneapolis-St. Paul area noted that used-car sales were strong in July as customers switched from trucks and SUVs to smaller vehicles.

Overall, tourism was down slightly from a year ago. The number of visits to attractions in South Dakota was down from last year in July, including about a 7 percent decrease for Mount Rushmore and a 9 percent decrease in retail sales at the Sturgis motorcycle rally. Visitor counts were down slightly from a year ago in northwestern Wisconsin, but resort bookings and retail sales were solid, according to an official. Travelers seem to be staying closer to home--not as many tourists are making long trips. Meanwhile, tourism activity in western Montana was up from a year ago.

Construction and Real Estate
Commercial construction activity increased, while residential construction softened. A representative of a commercial property firm noted recent increases in construction activity for industrial, office, medical, and retail developments in the Minneapolis-St. Paul area. For example, developers announced plans for a 700,000-square-foot office development in suburban Minneapolis, and medical centers are building over 835,000 square feet of additional space. Recent commercial permits were above year-ago levels in Sioux Falls, S.D., and Grand Forks, N.D. Residential building permits in July for Minneapolis-St. Paul were 37 percent below their 2005 levels. Residential construction slowed in Rochester, Minn., and Fargo, N.D. Bank directors from western Montana noted the home-building boom there has eased.

Commercial real estate was solid. The office market in Minneapolis-St. Paul saw further declines in vacancy rates in July; however, absorption of industrial space eased amid higher rents. Commercial real estate brokers in Sioux Falls described the market there as strong, and Fargo saw heavy demand for retail space.

Meanwhile, residential real estate weakened further. The number of homes on the market continued to climb in Minneapolis, although at a slower pace in recent weeks, with sales volumes falling. July home sales were down 26 percent from a year ago in Fargo, while the demand for high-end homes eased in Sioux Falls.

Manufacturing
Manufacturing activity expanded. An August survey of purchasing managers by Creighton University (Omaha, Neb.) indicated solid growth of manufacturing activity in the Dakotas and Minnesota. A paper mill in the Upper Peninsula of Michigan will invest over $50 million in capital improvements over the next two years. A new meat packing plant is planned in South Dakota. In Minnesota, an airplane component manufacturer plans to expand a facility and an all-terrain vehicle engine manufacturing plant is under construction. A lime products company plans to add production capacity in northwestern Wisconsin. A construction equipment manufacturer in Wisconsin reported strong demand, while a Wisconsin lumber producer said demand from residential building materials has declined sharply.

Energy and Mining
Activity in the energy and mining sectors increased since the last report. Oil and gas exploration and production in the District increased, and the alternative energy industry, including wind, biodiesel, and ethanol, continued to expand. Mining production is robust across the District. A Montana gold mine plans to reopen early next year after shutting down last year due to landslides. Several companies continue to explore new mining sites throughout the District.

Agriculture
Agricultural activity decreased since the last report. Drought conditions were evident across most of the District, which negatively affected crop yields. Responses to the Minneapolis Fed's second-quarter (July) agricultural credit conditions survey indicate that overall agricultural income will be down in the third quarter of 2006 due to reduced yields and higher input costs. Over half of South Dakota's sorghum, sunflower, and alfalfa crops are rated as "poor" or "very poor" by the U.S. Department of Agriculture. Most of the pastureland and rangeland in Minnesota and the Dakotas were rated as "poor" or "very poor." However, a record cranberry crop is expected in Wisconsin.

Employment, Wages and Prices
Labor markets tightened slightly since the last report. Nonfarm employment in District states was up 1.9 percent in July compared with a year ago. Employers in the Upper Peninsula reported a severe shortage of available workers for jobs involving electrical, hydraulic, and mechanical systems. A survey of online recruiting sites showed that Minneapolis-St. Paul area job postings in July remained unchanged from June, but at relatively strong levels; postings for science and education were up, while those for health care were down.

In contrast, a light truck manufacturer recently announced plans to reduce shifts from two to one by the end of the year, which will affect 700 jobs. An airline with service to North Dakota airports will lay off 85 ground workers by the end of the year.

Overall wage growth accelerated slightly. Wages paid by farm operators to hired workers in Minnesota, Michigan, and Wisconsin increased more than 5 percent in July compared with a year earlier. Wages for manufacturing workers in District states increased 2.6 percent in July compared with a year ago. In July 2005, wages increased 1.9 percent from a year earlier.

Price increases were noted for some building and energy products. Prices for asphalt, concrete, copper, steel mill, and plastic construction products posted notable increases. Gasoline prices in Minnesota for the third week in August were down slightly from a few weeks earlier, but up 37 cents per gallon from a year ago. A bank director noted that several contacts mentioned the high cost of health insurance as a key issue facing their businesses.

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Tenth District--Kansas City

The Tenth District economy expanded modestly in late July and early August, with the pace of growth easing somewhat from the previous survey period. Labor markets continued to expand solidly, energy activity increased further, and commercial real estate activity improved. However, growth in consumer spending and manufacturing activity slowed, and residential real estate activity declined. Agricultural conditions generally remained unfavorable due to drought. Wage pressures continued to build, but wholesale price pressures eased slightly and retail price pressures remained modest.

Consumer Spending
Consumer spending expanded more slowly in late July and early August than earlier in the summer. Slightly fewer retail contacts reported increases in sales from the previous survey period, and several store managers reported a decline in expenditures on discretionary items, such as jewelry. However, most stores continued to report year-over-year gains in sales. The share of store managers satisfied with inventory levels fell slightly, and retail contacts were somewhat less optimistic about future sales than in previous surveys. Similar to other retailers, the share of auto dealers reporting recent increases in sales eased somewhat in late July and early August. Auto sales were still generally down versus a year ago, and sales of trucks and SUVs were particularly weak at most dealerships. Auto contacts were less upbeat about future sales than earlier in the summer, and several dealers expected an increase in inventories in the months ahead. Travel and tourism activity fell slightly in late July and early August compared with the previous survey period. Airport traffic and hotel occupancy rates edged down but were still at about year-ago levels. Most hotel and tourist attraction operators expected modest increases in activity heading forward.

Manufacturing
Growth in manufacturing activity eased somewhat in late July and early August, while expectations for future activity strengthened. Plant managers reported that production, shipments, and new orders continued to increase, but at a slower rate than in the previous survey period. Oil and gas-related manufacturing remained very strong in the District, though, and several aircraft parts manufacturers announced sizeable expansions. Capital spending plans in general rose solidly, following a moderate easing in prior surveys. Contacts' optimism about future shipments and orders also rebounded, and expectations of backlogs increased. Most factories reported little change in material availability, although some contacts noted concerns about future availability due to increased railway congestion.

Real Estate and Construction
Residential real estate activity fell in late July and early August, while commercial real estate activity improved further. Home builders reported a decline in home starts and expected further declines in the months ahead. Similarly, most residential real estate agents said home sales were down from the previous survey period and that they anticipated additional slowing. Inventories of unsold homes continued to rise across the District, with sizeable numbers of foreclosures contributing to the increase in some cities. In most of the District, contacts reported that the weakest recent housing starts and sales have been for high-end homes. In higher-priced Colorado, on the other hand, most contacts reported that entry-level and mid-range homes have experienced the weakest recent activity, while construction and sales of high-end homes have generally remained solid. Home prices were generally flat compared with the previous survey period and up only modestly from a year ago. Mortgage lenders reported weaker demand for both home purchase loans and refinances, and they expected continued weakness in the months ahead. Commercial real estate activity improved in late July and early August. Office vacancy rates fell in most cities, and prices for office space were generally higher. Most commercial real estate agents expected continued solid improvement in office markets in coming months.

Banking
Bankers reported that loans increased somewhat since the last survey, while deposits held steady. Demand for agricultural loans rose slightly, while demand for commercial and industrial loans edged down. On the deposit side, CDs were higher than in the prior period, while demand deposits were slightly lower. A few respondents reported raising their lending rates since the last survey, and lending standards were basically unchanged.

Energy
Energy activity continued to increase in late July and early August. The count of active oil and gas drilling rigs in the region rose slightly and remains well above year-ago levels. With energy prices expected to remain high, contacts continued to be very optimistic about future drilling activity. Most contacts reported that labor shortages were the main constraint on expansion of drilling and that many companies were bidding away workers from other firms.

Agriculture
Agricultural conditions generally remained unfavorable in late July and early August. Since the last survey, widespread rains provided some relief from the drought, but above-average temperatures generally prevented crops from improving. Pastures also continued to suffer from lack of moisture, causing cattle producers to either rely on dwindling hay supplies or liquidate herds. Despite the drought, the corn crop was reported to be in relatively good shape and development is ahead of the previous year. Contacts in the District generally expected production and yields to closely mirror those in 2005, though crop yields would be highly variable and dependent on local precipitation.

Labor Markets and Wages
Labor markets continued to expand solidly in late July and early August, and wage pressures increased. As in previous surveys, hiring announcements outpaced layoff announcements by a sizeable margin. Many of the new jobs announced were at aircraft parts manufacturing plants, call centers, and professional services firms. The majority of contacts continued to report labor shortages. Among the workers reported to be in short supply were experienced sales workers, oil and gas workers, and skilled manufacturing workers. The share of businesses experiencing wage pressures rose slightly, and a larger share of contacts than in previous surveys also expected wage pressures to continue to intensify.

Prices
Wholesale price pressures eased slightly in late July and early August, while retail price pressures remained modest. The share of manufacturers reporting rising raw materials prices edged down from the previous survey but was still very high. The most frequently cited materials price increases by manufacturers were for copper and aluminum. Most contacts anticipated raw materials prices to continue to rise in the months ahead, but some firms expected prices to level off. The percentage of factories reporting higher finished goods prices also fell slightly from earlier in the summer, and the share of firms planning output price increases in the months ahead eased somewhat as well. Home builders reported further increases in some building materials prices, particularly copper and cement. This trend was generally expected to continue. Most retailers reported flat selling prices and expected only modest increases in the coming months.

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Eleventh District--Dallas

Eleventh District economic activity grew quite strongly from mid-July to late August, but there were more pockets of softness than in the last report. The energy industry is still expanding as rapidly as possible. Service sector activity is strong, although a few contacts noted some possible signs of weakness. Manufacturing activity is high but continued to cool. Real estate activity remained robust. A slight slowing in residential activity was offset by swelling nonresidential building. The financial services industry reported good overall credit quality, but consumer lending has weakened some. Agricultural conditions are still very dry.

In general, contacts blame recent pockets of softness on weakness in national housing markets and on high gasoline and electricity costs, which have dampened consumer spending. Several respondents said they have recently become more cautious about the outlook for activity, and some firms were adjusting inventory management or business plans to be more cautious about the possibility of additional slowing growth.

Prices
Price pressures were mixed. Crude oil prices have been high and volatile, pushed up by strong demand, supply disruptions and geopolitical fears. The price of light sweet crude oil peaked at $77 per barrel during the period, an all-time high in nominal dollars, and then decreased to near $70. Natural gas prices strengthened during the period, pushed up by strong demand for electric power generation, but high inventories are keeping natural gas prices low relative to those for oil. High shipping and energy costs continued to squeeze profits and put upward pressure on selling prices for most industries. Fuel surcharges have escalated, according to contacts, who say firms are passing these to selling prices as much as possible. There were also reports of increases in some raw materials prices. Real estate prices--including median home prices--continued to rise at a modest pace. In the high-tech sector, some prices were falling more slowly than normal, because rising raw material and transportation costs were being passed to customers. Farmers and ranchers reported soaring fuel, fertilizer, seed and irrigation costs.

Some prices were lower, mostly as a result of weakened demand. Some retailers said stiff competition had resulted in larger markdowns. Prices were lower for a few construction-related inputs, such as steel and aluminum. Gasoline prices remained high but are trending downward, with the average retail pump price falling under $2.70 per gallon in late August.

Labor Market
The labor market continued to tighten. At the same time, soft demand led a handful of manufacturers to freeze hiring or consider layoffs. Rising wages are being reported by a growing number of industries, and there are sharp increases for skilled workers that are in short supply.

Reports of worker shortages have become more numerous and, in some instances, more forceful. There are shortages of skilled workers for a broad range of occupations, including in oil field services, construction, accounting, trucking, engineering, and financial services. Non-skilled workers are also increasingly in short supply. A temporary service firm says one manufacturer is hiring workers without experience and paying them minimum wage to undergo training for a few weeks before being accepted as temporary workers.

More contacts expressed difficulty finding workers who can pass drug tests or provide papers proving that they are legal. Concerns about immigration reform have become palpable. A large commercial construction firm said disruption to the immigrant flow is the biggest threat the construction industry has faced in many decades.

Manufacturing
Manufacturing activity remained quite strong, but there was some softness in sales of construction-related products and increased concern about slowing demand for high-tech products. Still, energy-related manufacturing remained very robust, including the refinery industry, which has finally returned to normal levels of capacity utilization since last year's hurricanes.

Orders softened slightly but remained quite strong for construction-related products, such as lumber, stone, brick, glass, primary and fabricated metals. Some contacts noted a drop in demand from home builders, with a brick producer reporting a sharp increase in cancellations. Others said orders for nonresidential construction were keeping activity strong. Overall uncertainty had increased, but contacts were optimistic that orders would bounce back, suggesting that the recent slow down in residential construction might be partly due to hot weather.

Reports from the high tech sector were mixed. Demand remained strong for some products, particularly for newer technologies. One manufacturer said that his biggest problem is trying to find additional capacity to fill orders. Demand continued to soften for older technologies, such as lower-end PCs and memory chips. Contacts say it is unclear if orders will continue to slow or are just pausing.

Despite high prices, gasoline consumption was up roughly 2 percent from last year. Demand has also been strong for most major petrochemicals. Renewed exports helped ethylene sales bounce back, as the weakness in natural gas prices relative to oil prices has reopened export markets for U.S.-produced ethylene. Polyethylene and polypropylene plastics have also experienced strong domestic demand.

Paper producers said sales were flat over the past month. Food producers say sales volume has been unchanged.

Services
Activity in the service sector was still strong. Temporary service firms say activity is above a year ago, and demand is broadbased across most sectors of the economy. Accounting contacts say demand for their services is stable. Law firms reported a slight pick up in activity.

Activity in the transportation sector continued to increase, although there was a slight decline in airline bookings and cargo volume. Shipments of construction-related materials dropped off sharply. Traffic volumes for grain also softened because dry weather has weakened crop production. The trucking industry says the outlook has improved because of growing international trade and expansion at the Port of Houston.

Retail Sales
Retail sales continued to be mixed, but overall sales growth was still sluggish and below expectations. High gasoline and air conditioning bills have been absorbing discretionary income, according to contacts, who say that consumers are very price conscious. Retailers have become more cautious about the outlook and say they are buying inventory more carefully.

Auto sales were mixed. Some dealers reported a slight increase in volume but others reported substantial declines. Sales continued to be strong for luxury and fuel efficient vehicles, but sales of pickup trucks have been particularly poor.

Construction and Real Estate
While still at high levels, home sales continued to cool over the past six weeks, especially for lower priced homes. Incentives spurred sales of moderate and high priced homes. Builders reported continued strength in traffic and sales but say it is taking a little longer to close deals. There were a few reports of sales cancellations, mostly because buyers were unable to sell their West Coast homes. Demand for apartments is keeping pace with supply, according to contacts, but many continued to express concern that Dallas condominium construction might overshoot demand.

Contacts say office leasing activity has been strong over the past six weeks, with more requests for larger blocks of space from local firms and relocations. New development has picked up in several areas, especially in Dallas. Respondents say construction is based upon fundamentals, with demand and rental rates justifying the additional space. Other nonresidential segments, like retail, continued to see increased construction activity, but a few contacts said the amount of construction warranted watching. Public construction activity remained robust.

Financial Services
Industry contacts continued to report steady loan demand and deposit growth. Competition for commercial loans and deposits has been intense. Consumer lending activity softened. Contacts say consumers are being more cautious, paying down debt and not taking on additional debt at the higher rates. Overall credit quality remained strong.

Energy
The U.S. rig count added over 100 rigs during the period, with two-thirds in Texas. Soft natural gas prices have led to a slight shift in the percentage of rigs drilling for oil instead of natural gas and gave operators a little more leverage in negotiating day rates for land rigs. Day rates have flattened out, but not fallen. The rig count increased slightly in the Gulf of Mexico, and interest in the deep waters of the Gulf is strong. Shallow water rigs continued to leave in favor of higher day rates and lower insurance bills elsewhere in the world.

Demand for oil services and machinery remained strong, with continued large backlogs and limited service capacity. Service firms reported pricing leverage, and said they are building most of their increased revenue supporting strong international activity.

Agriculture
Some contacts are referring to this drought as the worst since the 1950s. More than 50 percent of the cotton, corn, sorghum and soybean crop is in poor to very poor shape. Dryland crops have been written off as losses in many areas, and most farmers are not planting a second crop. Yields for irrigated crops are expected to be lackluster. A lack of water and forage, along with high feed costs, has led cow-calf operators to cull their herds at a higher-than-normal rate. Contacts say the increased number of cattle being liquidated will cut calf production in half next year and severely impact beef supplies over the next few years.

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Twelfth District--San Francisco

Economic activity in the Twelfth District expanded during late July and August at the solid but reduced pace established in the previous survey period. Wage and price inflation were limited on net, with reports indicating substantial variation across sectors in the degree of wage and price pressures. Reports on retail sales suggested modest growth overall, while demand for most services continued to expand at a brisk pace. Demand and sales remained strong for manufacturers and producers of agricultural and resource-related products. Residential construction activity, sales, and price appreciation continued to decelerate in most areas, while commercial real estate activity expanded further. District banks reported solid loan demand on net, although residential mortgage lending slowed further.

Wages and Prices
District reports indicated that overall price inflation remained modest. Energy cost increases moderated, although some contacts noted that the pass-through of earlier increases in energy costs exerted significant upward pressure on final prices of selected energy-intensive goods and services, such as construction materials and transportation services. Price movements more generally were mixed. Some contacts reported increased pricing power and larger price increases for some retail items and manufactured goods, while others noted flat or declining prices for selected building inputs and for products in very competitive markets, notably apparel and electronic goods. District labor markets were largely stable, with little or no change in tightness evident, and wages continued to rise at a moderate pace overall. A few contacts reported a recent reduction in wage pressures, although wage increases remained rapid for workers with specialized skills in various sectors, notably in financial and health services.

Retail Trade and Services
Growth in District retail sales was modest on net. Sales grew somewhat for department stores and assorted specialty retail establishments, although sales slowed for establishments specializing in products used for home improvement. Demand for automobiles changed little from the previous survey period. High gas prices reportedly held down demand for fuel-inefficient vehicles such as large SUVs and light trucks, while sales of fuel-efficient vehicles continued at a solid clip.

Most service providers saw robust demand. Activity rose further in the health-care, transportation, and professional services sectors. Travel and tourist activity remained at very high levels in most major District markets; contacts provided no reports of adverse effects from heightened airport security arising from the recently uncovered terrorist plot in the United Kingdom, although it may be too early for these effects to appear. In Hawaii, rising domestic tourist arrivals and spending continued to offset a decline in Japanese tourism and generate solid gains overall, although hotel occupancies were down a bit from year-earlier levels.

Manufacturing
Demand for District manufactured products was strong on net during the survey period of late July and August. Semiconductor orders and sales grew at a solid pace, largely in line with industry sales forecasts; inventories were balanced and capacity utilization remained at or above 90 percent for many producers. In the commercial aircraft sector, further growth in orders and an existing backlog kept manufacturing establishments operating near full capacity in the Pacific Northwest. Contacts reported good demand growth and balanced inventories for processed food. By contrast, apparel manufacturers reported slightly slower orders and sales, with inventories slightly above desired levels. Demand fell for various building materials that are primarily intended for residential construction, but one respondent noted rising demand for fabricated metals due to increased nonresidential construction activity. District manufacturers reported plans to increase capital spending during the second half of 2006 at about the same pace as during the first half.

Agriculture and Resource-related Industries
Demand for District agricultural and resource-related products was strong during the most recent survey period. Sales were robust for most crops, notably for potatoes and various nuts, and weather conditions generally were favorable, keeping production on track for most crops and livestock. Elevated prices for fuel and fertilizers remained a concern for many agricultural producers, putting upward pressure on final prices; however, this was partly offset in some areas by increased labor availability and a corresponding reduction in wage pressures arising from reduced demand for labor in the residential construction sector. In the resources sector, producers of oil and natural gas saw robust demand and little or no excess capacity. However, inventories of natural gas remained high, further reducing prices.

Real Estate and Construction
Demand for residential real estate fell further in most areas, while activity in commercial real estate markets continued to expand. In most parts of the District, reduced home demand caused further increases in the inventory of available homes and continued declines in the pace of home sales and price appreciation. The cooler sales conditions damped residential construction activity in most areas. However, construction activity for commercial and public structures rose further. In some areas, builders continued to face significant cost increases and project delays due to tight supplies of skilled workers and selected construction materials. Vacancy rates on commercial space fell further in most parts of the District, and rental rates continued to rise.

Financial Institutions
District banking contacts reported solid loan demand and good credit quality overall. Demand for commercial and industrial loans and for commercial real estate loans has been strong and grew further in some areas, while residential mortgage originations and refinancing activity continued to slow. Contacts reported that indicators of credit quality, such as loan delinquencies, were at favorable levels in general. Several banking contacts reported ongoing increases in capital spending on information technology equipment, partly as a means to offset growing labor shortages for some groups of workers.

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