January 18, 2006

Summary of Commentary on Current Economic Conditions by Federal Reserve District

Summary

Prepared at the Federal Reserve Bank of Cleveland and based on information collected before January 9, 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.

Economic expansion continued across the twelve Federal Reserve Districts through the last several weeks of 2005. Six--New York, Philadelphia, Chicago, St. Louis, Minneapolis, and Kansas City--characterized their economies as expanding moderately or modestly. Activity accelerated or increased at a solid pace in the San Francisco, Richmond, Atlanta, and Dallas Districts. Boston characterized activity as continuing to expand, while Cleveland reported that conditions remained reasonably strong.

Most Districts reported moderate increases in employment. Labor markets tightened in some areas and for some occupations, but on the whole, wage increases were characterized as moderate. Contacts reported that input-price pressures have continued for many items, particularly early in the supply chain, but they were less intense at year-end than earlier. Retail prices and producers' prices for more finished goods, however, were widely reported as rising only moderately or remaining stable.

Retail sales rose in most Districts, and those Districts that reported on travel and tourism spending said it was generally strong. Increases in manufacturing activity were widely reported. Most Districts indicated some cooling in residential real estate activity, while many noted that commercial real estate activity generally continued to improve. Consumer borrowing was flat or fell in most Districts, while commercial borrowing was more mixed, with many Districts reporting moderate increases in activity. Conditions in the energy sector seemed strong, while agricultural activity was mixed.

Prices

Several Districts (San Francisco, Kansas City, Chicago, Richmond, Cleveland, Philadelphia, and Boston) reported that increases in energy prices moderated or actually fell, albeit from high levels. In the San Francisco, Cleveland, and Richmond Districts, these developments were thought to be associated with a wider easing in overall price pressures. However, in the remaining nine Districts, nonlabor-input-cost increases continued to concern companies, particularly those in the manufacturing sector. Producers were reported to have attempted to recoup these costs, although, according to the Atlanta, Boston, San Francisco, and Dallas Districts, intense competition was thought to be holding down price increases in parts of the supply chain further "downstream." Increases in the prices of construction materials were widely reported.

Retail prices were generally regarded as stable, though there was some significant discounting reported in the Cleveland and Atlanta Districts during the holiday selling season. More moderate discounting was reported in the Dallas District, levels about the same as last year were reported in the San Francisco District, and no widespread discounting was reported in the Philadelphia District. Price increases are planned in the months ahead by a large share of retailers, according to the Kansas City District.

Employment and Wages

Most Districts reported signs of continued, if generally moderate, increases in employment. Cleveland, Minneapolis, and Richmond all cited moderate employment gains, with Richmond noting that its rate represented a slowdown. New York, Atlanta, Kansas City, and Dallas reported evidence of stronger employment growth. However, Boston noted that output growth had generally not translated into higher employment, while St. Louis reported a widely mixed pattern of layoffs and hiring. Hiring at financial and legal services firms is boosting the New York District's employment growth, although New York also reported some hiring at manufacturers. Atlanta reported strong demand for both skilled and unskilled labor, in part boosted by storm-recovery efforts.

Atlanta reported several locations with tight labor market conditions, while Boston, New York, Philadelphia, Chicago, Kansas City, Dallas, and San Francisco all reported specific occupations in which jobs have been difficult to fill. Several of the Districts cited trucking jobs. Skilled construction workers are relatively sought after in Chicago and Atlanta, and skilled manufacturing jobs were mentioned by Boston, Chicago, and Dallas. Atlanta listed a variety of specialties in "extreme shortage." New York and San Francisco reported that finance-industry labor markets were relatively tight. Despite reports of labor market tightness, Boston, Philadelphia, Minneapolis, Kansas City, and Dallas all noted that wage increases have been generally moderate. However, New York, Chicago, and Dallas all reported some acceleration in compensation.

Consumer Spending

All Districts reported that their retail sales rose during this latest holiday selling season except Cleveland, where sales were generally flat or less than at this time a year ago. Philadelphia, Chicago, St. Louis, Minneapolis, and Kansas City reported modest to moderate increases. Boston, New York, Richmond, Atlanta, Dallas, and San Francisco reported stronger holiday sales than these Districts. The Cleveland, Richmond, Chicago, Minneapolis, and Dallas Districts noted significant increases in gift card sales, which led retailers in Richmond and Dallas to anticipate stronger sales and profits in early 2006. Most merchants appear to have carefully controlled their inventories, which are generally at desired levels.

Automobile sales were generally somewhat sluggish across the nation. Dealers fared best in the Richmond, San Francisco, and Dallas Districts, where sales improved from low levels. Sales trends were somewhat more mixed in the Chicago and Atlanta Districts. Atlanta and Philadelphia reported that sales remained strong for foreign brands, even as demand waned for domestic ones, sales of which were reportedly not helped much by manufacturers' promotions. Philadelphia and Kansas City characterized truck and SUV sales as especially slow.

Travel and Tourism

Travel and tourism remained robust across most of the country. The San Francisco District reported that travel and tourism spending in Hawaii toward the end of the year occurred at a record-setting pace. Elsewhere, ski resorts throughout the Kansas City and Minneapolis Districts have done well this winter, though a few areas have suffered from a lack of snow. In the Southeast, the Atlanta and Richmond Districts also reported robust activity, some of which was thought to be the result of unusually warm weather. Tourist activity appeared to be recovering somewhat in hurricane-affected areas. Finally, in the Northeast, travel and tourism remained strong.

Manufacturing

Increases in manufacturing activity were widely reported across the country. Only the St. Louis District characterized industrial activity as mixed. Elsewhere, robust expansion was reported in the San Francisco, Dallas, Kansas City, Minneapolis, Chicago, New York, and Boston Districts. More moderate expansion was indicated in the Cleveland, Richmond, Philadelphia, and Atlanta Districts.

Production of high-technology goods was steady to slightly increasing toward the end of 2005, according to the San Francisco and Dallas Districts. And defense and aerospace industry production improved in the San Francisco, Boston, and Atlanta Districts. Manufacturers of machine tools and industrial equipment also reported more robust demand in the San Francisco, Chicago, and Philadelphia Districts. Production of construction-related materials and equipment expanded noticeably in the San Francisco, Dallas, Chicago, and St. Louis Districts but was characterized as slightly less strong in the Boston District. Primary metals producers reported strong demand in the Cleveland, Chicago, and Dallas Districts. Producers of plastics and petrochemicals noted some slowing in demand in the Philadelphia and Dallas Districts, though this was from fairly high levels. By contrast, reports from the Richmond and St. Louis Districts suggested some improvement in the sector. And weakness in the textile industry was reported in the Boston, Richmond, and Atlanta Districts.

In the transportation equipment sector, reports from the Boston, Philadelphia, and Atlanta Districts suggested weakness among automakers and their suppliers. However, in the Cleveland and Chicago Districts, activity appeared to be somewhat stronger. Heavy truck production was also characterized as improving in the Chicago District. Conditions in the transportation equipment sector were more mixed in the St. Louis District.

Trucking and Shipping

Trucking and shipping demand remained strong across the country, but companies were constrained by continuing driver shortages in the Atlanta, Cleveland, Chicago, and Philadelphia Districts. In addition, despite the ongoing use of fuel surcharges, contacts in Cleveland, Dallas, and Atlanta noted that margins tightened because of fuel-cost increases. Cleveland and Dallas reported plans for increased capital spending in the trucking industry. Dallas also reported that both railroads and airlines saw rising demand.

Construction and Real Estate

Many Districts reported moderation in residential real estate activity, although from a high level. Boston, New York, Cleveland, Richmond, Atlanta, Chicago, and Minneapolis reported some cooling in real estate markets. While some of the hottest markets in the San Francisco District have cooled--for example, Southern California and the San Francisco Bay Area--other areas, such as Oregon and especially Hawaii, have reportedly heated up further. Kansas City and Dallas continued to see strong housing markets. And construction and repair work remained brisk in Louisiana and Mississippi.

Conditions in Districts' commercial real estate markets generally continued to improve. Vacancy rates fell in the San Francisco, Minneapolis, New York, Dallas, Richmond, and Kansas City Districts. Chicago reported a more mixed picture, with some areas of the District expanding but activity in the city of Chicago flat. Largely because of lower vacancy rates, rents rose in San Francisco and New York, while previous concessions were reduced or eliminated in Dallas. New construction activity was reported to be increasing in the San Francisco, Minneapolis, St. Louis, Atlanta, and Cleveland Districts, and many contacts expect this trend to continue in 2006.

Banking and Finance

The Cleveland, Kansas City, Philadelphia, San Francisco, and St. Louis Districts saw moderate increases in commercial lending activity, while Chicago and Richmond reported that activity had slowed and Atlanta reported that activity was mixed. Consumer lending was flat or fell slightly in the Atlanta, Chicago, Cleveland, Kansas City, New York, Richmond, St. Louis, and San Francisco Districts. The Philadelphia District was an exception, noting gains in consumer and residential real estate loans, but contacts noted that they expected lending for residential real estate to experience modest declines in the future. In the Dallas District, deposit growth was strong, while Kansas City and St. Louis reported modest increases in total deposits. New York reported that conditions in the securities industry remained robust, with employees receiving significant increases in bonuses this year.

Energy and Natural Resources

Conditions in the energy sector were characterized as strong or stable at a high level by four of the five Districts reporting on natural resources. As a result, San Francisco, Dallas, and Kansas City all reported shortages of labor, materials, and equipment among energy-related enterprises. Producers of natural gas and oil reportedly operated near 100 percent capacity in the San Francisco District, while the Atlanta and Dallas Districts reported that facilities in the Gulf of Mexico continued to recover from hurricane-related damage. Minneapolis reported that most mining operations in its District were running near capacity.

Agriculture

Dallas, Kansas City, St. Louis, and Chicago all reported that low levels of precipitation were affecting crops and have the potential to lower yields in the spring, while Richmond reported that cold weather and abundant precipitation slowed harvesting activity in November and December. Citrus producers in the Atlanta and Dallas Districts expected a boost in profits from an increase in prices in the wake of substantial hurricane damage to the citrus crop in Florida. Livestock reports were mixed, with San Francisco reporting increases in sales, Chicago reporting rising cattle prices and stable hog prices, and Dallas and Kansas City reporting reductions or anticipated reductions in herd sizes.

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First District--Boston

Business activity continues to expand in the First District, although this growth is not generally translating into increases in employment. Retailers are upbeat about their end-of-year results compared with a year earlier. Manufacturers continue to see solid year-over-year growth in revenues. Advertising and management consulting firms also report healthy growth through the end of the calendar year. Residential real estate markets in New England continue to slow, but as indicated three months ago, contacts say this represents a return to normal, rather than a significant market correction. Business respondents say the outlook is positive, with most of them expecting "more of the same" in 2006.

Retail and Tourism

Retail contacts in the First District report positive results in November and December, as year-over-year sales range from flat to double-digit gains. Products that sold particularly well this holiday period include apparel and accessories, jewelry, wireless products, and other technology items such as personal computers and printers. Sales of big-ticket items were not as strong, and an automobile dealers' group indicates that sales are flat.

Inventory levels are generally in line with plans. Vendor prices and selling prices are mostly stable, although several respondents still cite price pressure on energy-linked products. Many contacts report increased seasonal hiring, but note that headcount levels are now returning to pre-holiday numbers. Most contacts plan to increase capital spending in association with new store openings; however, several respondents say they will tighten up capital spending plans this year.

A travel and tourism contact reports a stronger end-of-year season than anticipated, and partly credits a return to holiday and corporate parties at area hotels and restaurants. A robust 2006 is forecast for travel and tourism, with a large number of advance bookings.

Overall, most retail and tourism contacts are cautious, but optimistic about the new year.

Manufacturing and Related Services

First District manufacturers reportedly ended 2005 with good momentum, as most contacts recorded positive year-over-year growth in the fourth quarter. Almost half achieved double-digit gains in revenue and a similar share describe results as "better than expected." While many firms saw strong demand across the board, areas of particular strength included pharmaceuticals, aerospace, and security and monitoring equipment. Demand for textiles, automotive products, and building and other transport equipment is said to be less robust.

While many contacts mention recent moderation in the price of steel, aluminum, energy, and petroleum-based products, some also note that copper and sterling prices continue to rise. Over half say that their selling prices are now above year-ago levels, generally by 1 percent to 3 percent. Still, most manufacturing respondents describe their ability to protect their profit margins by passing commodity price increases on to customers as very limited. Two contacts also mention that the strong dollar has damped sales or reported profits.

A majority of district manufacturing contacts plan to keep employment at current levels in 2006. Several firms indicate that they are restructuring their workforce, with gains in sales and development or engineering offsetting cuts in HR, back office, or production functions. Most contacts raised wages by 3 percent to 3.5 percent in 2005 and are planning the same or slightly higher increases in 2006. Respondents giving above-average increases cite a need to share improved profits or tightening labor markets.

At over half of the respondents, domestic capital spending will be little changed or down from 2005 levels in 2006; a minority plan to increase investment significantly. Firms with conservative spending plans point out that projects started earlier are near completion, much spending is overseas, excess capacity exists, or they are investing more efficiently.

Most manufacturing contacts expect that 2006 will turn out much like 2005, which they describe as "pretty good" and "sweet." A minority see the economy as vulnerable to weak house prices and slower consumer spending or an unexpected event.

Selected Business Services

New England advertising and management consulting companies experienced healthy revenue growth in the final quarter of 2005, with most firms reporting double-digit gains from a year earlier. Some contacts note that their clients' budgets are less constrained than a year ago; in response, the contacts are expanding their product and service offerings.

Responding consulting companies have earned moderate price increases over year-ago levels with no discernible effect on demand, while advertisers' prices have held stable due to a competitive market environment. Business costs are rising moderately for all contacts, most notably for labor, where wages are up between 3 percent and 4 percent from a year ago. Firms report that headcounts are growing to accommodate demand, but at a slightly slower rate than revenues. Most advertising and consulting respondents have a positive outlook, expecting revenue growth to be flat or accelerate over the course of 2006, despite some concerns about a general economic slowdown.

Residential Real Estate

Contacts across New England report declining levels of residential real estate activity in the fourth quarter of 2005. In Massachusetts, the October volume of single family sales was down 8.7 percent from the previous year, while November sales were down 9.2 percent. Condominium sales were up 7.5 percent and 0.8 percent for the same two periods; one in three properties sold in Massachusetts is a condominium. Declining activity is at least partly attributable to rising mortgage rates pushing some buyers from the market, along with sellers who are attempting to maintain current asking prices.

Inventories and market times are moving up to what contacts characterize as more normal or healthy levels. The Massachusetts market currently features eight months of supply; one contact put market equilibrium at 8.5 months. Buyers, faced with more property choices, are researching more and negotiating harder. Prices are beginning to respond to increased buyer power, though contacts are quick to point out that any talk of declining prices or downward market corrections is premature. Prices are still increasing, though moderately.

Contacts uniformly expect activity to increase in mid-January for spring closings. Growth projections are very moderate, but positive. One contact expects 2006 price appreciation rates of less than 5 percent in Massachusetts.

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Second District--New York

The Second District's economy continued to expand at a moderate pace during the final weeks of 2005, although there were some further signs of softness in the housing sector. New York City's three-day transit strike appears to have had only limited, localized impacts in a few areas. There is no indication of a significant acceleration in consumer prices, though manufacturers report continued widespread price pressures. The labor market has shown further signs of strengthening, for both office workers and factory workers. Conditions in the financial sector remained strong in late 2005, and bonus payments are expected to be up 15-20 percent from last year. Retailers report mixed, but generally favorable sales results. The residential real estate market has shown further signs of cooling, but commercial real estate has strengthened. Finally, bankers report some further weakening in demand for consumer loans and residential mortgages and increased delinquency rates in both those categories.

Consumer Spending

Retailers report that holiday season sales were on or close to plan, with particular strength noted in the final week of December and in early January. Stores in Manhattan report notable declines in sales during New York City's three-day transit strike, but retailers in the outer boroughs generally indicate little or no effect. Weekly surveys of New York retailers indicate that, for the state as a whole, sales were up 2.5 percent from a year earlier, with a similar gain during the week of the transit strike. Major retail chains report that same-store sales in this region ranged from a 2 percent decline to a 4 percent gain. Retail inventories were said to be at favorable levels at year end. A number of retail chains indicate that selling prices for comparable products were flat to down slightly from a year earlier, but again note a shift in the demand mix toward higher quality and higher priced products.

Tourism has remained strong since the last report. Manhattan hotels report brisk business in December, with the transit strike apparently having little net effect. Occupancy rates remained close to 85 percent in December and were little changed from a year earlier, and total revenues were up roughly 15 percent--even during the week of the transit strike. Broadway theaters report that both attendance and total revenues dipped noticeably during the week of the transit strike but bounced back strongly in the final week of December. For the month as a whole, attendance was down marginally from a year earlier but revenues were still up roughly 20 percent--from gains of over 20 percent in October and November.

Consumer confidence in the region ended 2005 on a strong note. Based on the Conference Board monthly survey of residents of the Middle Atlantic states (NY, NJ, PA), consumer confidence posted its third consecutive monthly gain in December, rising to a five month high.

Construction and Real Estate

The region's housing market showed further signs of weakening in the final weeks of 2005. New Jersey homebuilders report that home sales activity has slipped well below year-ago levels and that the inventory of homes on the market (mostly existing homes) has increased markedly. Also, builders are reported to be offering more free upgrades and concessions to buyers. Still, there is virtually no speculative building, and there continues to be a 6 to 9 month backlog for new homebuyers. A variety of building materials--pipes, gypsum, shingles, etc.--have increased noticeably in price, though lumber prices have reportedly been restrained by some easing in tariffs and trade restrictions. Also, while the market for construction workers remains tight, no significant wage pressures are reported. In New York State, the market for existing homes showed signs of cooling in November: unit sales slipped 7 percent from a year earlier, though the median selling price was still up roughly 20 percent. Manhattan's co-op and condo market has also shown some signs of softening since the last report. A major appraisal firm and a leading real estate firm both report that while selling prices continued to run well ahead of a year earlier in the fourth quarter, sales activity declined noticeably and the inventory of apartments rose further; most of the weakness in recent months has been in the market for larger (2-3 bedroom) apartments. Looking ahead to the first half of 2006, a number of industry contacts expect that upcoming Wall Street bonuses will buoy the high end of the market.

Commercial real estate markets across the New York City metropolitan area showed broad-based strengthening in the fourth quarter of 2005. Vacancy rates in northern New Jersey, lower Manhattan and midtown Manhattan fell by at least 1½ percentage point for the quarter and were down by roughly 2 points from the end of 2004. Vacancy rates in Long Island and the lower Hudson Valley were down marginally. Asking rents were up moderately across most of the region. Industrial markets were mixed in the fourth quarter: Long Island's industrial vacancy rate fell to a five-year low, but rates in Westchester and the lower Hudson Valley rose modestly, while northern New Jersey's rate was little changed.

Other Business Activity

A major New York City employment agency, specializing in office jobs, reports increasingly tight labor market conditions, with the number of quality jobs far exceeding the number of quality candidates. This contact also notes some acceleration in wages; most of the recruiting activity continues to be in the financial and legal services industries. Conditions in the securities industry remained fairly strong in the fourth quarter, according to an industry expert, though not quite as robust as in the third quarter. Still, bonuses are expected to be up 15 to 20 percent from last year; an even larger than usual share of bonus payments will reportedly be made during 2006:Q1, rather than 2005:Q4, due to the year-end expiration of a state tax surcharge. In contrast, some consolidation is reported in the hedge fund industry, though the effect on overall finance-sector employment is seen as minimal.

Activity in goods production and distribution has also shown signs of expanding. A major shipping firm reports a steady and substantial increase in the volume of merchandise exports shipped through the northern New Jersey ports in recent months. This contact notes that 2005 was also a very strong year for incoming shipments at the port. New York State manufacturers report favorable business conditions at the end of 2005 and express fairly widespread optimism about prospects for the first half of 2006, as well as some increase in hiring plans. Manufacturers also note ongoing escalation in input prices, and a growing proportion report that they are hiking their selling prices.

Financial Developments

Small- to medium-sized banks in the district report weakening demand for consumer loans and particularly residential mortgages; in the latest category, 52 percent of bankers report decreased demand and only 7 percent report increased demand. Tighter credit standards are reported for both commercial mortgages and commercial and industrial loans, while standards for consumer loans and residential mortgages remained unchanged. Higher loan rates are indicated across all categories, but most notably on residential mortgages, where 72 percent of respondents report higher rates. Comparably widespread increases are reported on average deposit rates. Finally, delinquency rates rose moderately on consumer loans and residential mortgages but remained unchanged among commercial borrowers.

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Third District--Philadelphia

Economic activity in the Third District expanded moderately in December. Manufacturers reported increases in shipments and new orders during the month. Retail sales of general merchandise during the holiday season were above the same period in the previous year, although the extent of the increases varied from slight for some stores to strong for others. Auto sales eased as 2005 came to a close. Service-sector activity continued to expand at a steady, moderate pace. Business contacts in all industries noted continuing increases in the costs of materials and intermediate goods, and they indicated that wage and salary increases for 2006 will be somewhat greater than they were in 2005.

Third District business contacts generally expect business activity in the region to continue to expand at about its current pace. Manufacturers expect further increases in orders and shipments in the first half of the year. Retailers anticipate slight gains, but many are concerned that high home-heating bills will constrain consumers' discretionary spending. Auto dealers say the outlook is uncertain, and most of those polled at the turn of the year anticipate slower sales in 2006 than in 2005. Contacts among service-sector firms generally expect business to continue to advance at its current rate.

Manufacturing

Manufacturing activity in the Third District expanded in December at about the same pace as in November. About one-third of the manufacturing companies polled in December reported that new orders and shipments increased during the month, and about one-fourth reported slower new orders and shipments. Among the District's major manufacturing sectors, business improved relatively more in December for producers of food products, furniture, and electrical equipment. Producers of chemicals and industrial materials noted some slowing in demand for their products during the month, and producers of transportation equipment reported continuing declines in business. In other sectors business was steady or advancing modestly.

Overall, manufacturers expect growth in business activity to pick up during the first half of the year. Half of the firms contacted in December expect their shipments and orders to increase during the next six months; about one tenth expect decreases. This represents a slight improvement in regional manufacturers' outlook compared with their views in the early fall. On balance, area manufacturers plan to add workers and increase capital spending in the first half of the year.

Retail

Third District retailers reported year-over-year increases in holiday sales, although the extent of the gains varied among stores. In a continuation of the year-long trend, luxury-goods retailers posted strong annual increases, while mid-price department stores and discount stores had slight increases. Specialty stores had mixed gains. Sales increased in line with expectations at stores selling electronics and teen apparel, but for home furnishing stores, sales were virtually level with a year ago. Sales increased at adult apparel and accessory stores, although the gains were strong at only a few chains. Area retailers had stocked conservatively for the holiday season, and unplanned discounting was not widespread. Looking ahead, area merchants say the pace of sales will depend on the strength of gains in consumers' income and the impact of the cost of gasoline and home heating during the winter. Several store executives noted that consumers are curtailing shopping trips and limiting spending as they cope with higher energy costs this winter compared with a year ago.

Auto dealers in the region reported a slowing in sales in December. The falloff in sales was relatively greater for light trucks and sport utility vehicles than for cars. Sales of foreign makes did not weaken as much as sales of domestic makes. Dealers indicated that manufacturers' discounts and incentives were not stimulating sales as much as they did in the past, and they expect sales this year to be less than last year.

Finance

The volume of loans outstanding at Third District banks increased in December compared with November. Banks in the region posted gains in business, consumer, and residential real estate loans. Commercial bank lending officers said competition for loans continued to be strong. Overall, bankers indicated that credit quality remained good. Bankers in the District expect continued growth in lending to businesses and consumers during the winter. Most of the bankers contacted for this report expect some slowing in residential real estate lending, but most believe the decline is likely to be modest. Several bankers noted that the residential builders they finance are continuing to acquire land, although some builders anticipate that the pace of new home sales will be slower over the next few years than it was over the past several years.

Services

Most of the Third District service firms contacted in December reported that activity continued to expand at a steady, moderate pace, and some noted recent increases in the rate of growth. Business services firms have experienced growing demand from existing customers and new customers. Employment agencies and temporary help firms indicated that demand for workers has picked up recently. Trucking firms reported continuing high rates of activity, resulting in difficulty finding sufficient numbers of drivers. Most of the service-sector firms contacted in December expect business to continue to advance at about its current growth rate through the winter, although some employment agencies are uncertain about how long the recent increase in demand will persist.

Prices and Wages

Business firms in the Third District reported that they face continuing increases in costs of materials and intermediate goods. Although the rise in energy prices has ebbed, Third District firms say the impact of the higher prices will become more serious during the winter as their energy consumption rises seasonally. Many firms said they were reviewing ways to reduce energy use, and more firms plan to increase spending on energy-saving investments in 2006 than increased such spending in 2005. Some firms that have energy-intensive operations indicated they will attempt to recoup higher energy costs through general price increases rather than surcharges.

Employers in a range of industries noted that the salary schedules they are implementing for 2006 will raise wages by a greater percentage than the 2005 increases. Although the average step-up in increases is modest, firms indicated that they will be raising salaries significantly for some hard-to-fill occupational categories in order to retain current employees and to attract new hires. Many firms in the region reported that their employee turnover rates picked up noticeably in the fourth quarter, and employment agencies reported that there has been a recent increase in inquiries about jobs from currently employed workers. Hiring executives cite these developments as indications that labor markets have tightened.

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Fourth District--Cleveland

District business conditions remained reasonably strong through the last six weeks of 2005; however, business spending was somewhat stronger than that for households. In particular, holiday spending appears to have been weaker than the District's retailers had hoped for, while home and auto sales were down, and the provision of consumer credit was flat. By contrast, commercial construction and credit issuance rose at the end of 2005. In the manufacturing sector, durable goods producers saw shipment volumes rise, while shipments were steady for producers of nondurable goods. Finally, trucking and shipping services providers continued to report robust demand.

Reports suggested that input cost increases were more modest as the year ended, however more firms mentioned attempting to increase their own prices to try to offset previous increases in input costs. Overall, hiring still appeared somewhat limited throughout the District, though staffing services companies reported an increase in client orders, which was attributed to expectations of ongoing economic expansion in 2006.

Manufacturing

At the District's durable goods facilities, production levels continued to trend up through the last six weeks of 2005. Production activity was also generally reported to be above the levels of a year ago. Shipments from steel facilities in the District were stronger than typical at year-end, the consequence of a smaller stock of inventories and healthy demand from firms in other industries, notably the heavy truck, construction, and aerospace industries. And despite the consolidation of two Ford automobile assembly plants in the Cleveland area, District auto production increased on a year-over-year basis in the last two months of 2005. Among nondurable goods producers, production remained steady toward the end of 2005, but was generally less than at this time a year ago. While new orders growth continued to be tepid, most nondurable goods producers were still sanguine about their prospects in 2006.

Manufacturers generally reported that their overall input costs increased little through the last six weeks of 2005. Nevertheless, most producers reported raising their own prices, in an effort to mitigate earlier increases in input costs. Hiring appeared to strengthen somewhat among durable goods producers, but remains much more limited among nondurable goods producers.

Retail

The District's discount and department stores generally reported that their sales this holiday selling season were flat or less than at this time last year. Several contacts characterized their companies' results as disappointing. Contacts attributed lackluster in-store sales totals to an array of factors, including strong internet sales, increases in gift card sales, milder weather, and high home heating bills. By contrast, sales at specialty retailers were generally higher than at this time a year ago. The items that sold well among all retailers included personal care products, electronics, and some apparel goods.

Many retailers reported more markdowns and promotional activity throughout this holiday selling season than was true a year ago. Several contacts suggested that some retailers' desire to move merchandise may have come at the expense of profits. In addition, a few contacts noted that some sales were lost due to inventories that were managed "too" tightly. Regarding hiring, one contact noted that there will be staffing reductions during the spring season as a result of this firm's poor sales performance over the holidays.

Sales at District auto dealerships were down during the last six weeks of 2005, despite aggressive promotions among the "Big Three". As a result, dealers' inventories were generally characterized as above desirable levels.

Construction

In general, homebuilders saw their sales trend down as 2005 ended. Most builders reported that their sales in November and December were down from the same time a year ago. Overall, sales in 2005 for most firms were the same as or below the totals achieved in 2004. Builders' backlogs are also generally down from a year ago. And some respondents reported that the inventory of speculative homes seems somewhat bloated. Accordingly, discounts from a few builders have been unusually heavy. Overall, input cost increases were modest toward the end of 2005, with some contacts noting that their total costs increased less rapidly than they would have anticipated a few months ago. Contacts reported increases in the prices for petroleum-related products, such as plastics and transportation, and steel. By contrast, contacts reported that lumber costs have recently been flat or falling. Several contacts noted that they have been able to hold off some suppliers' requests for further price increases because of diminishing demand.

Unlike homebuilders, commercial contractors ended 2005 with an increase in activity, relative to this period a year ago. Additionally, business was better throughout 2005 for most firms than was true in 2004. Commercial builders' backlogs were also characterized as good. Most contacts reported that their firms had increased prices as the year ended, with some part of these increases intended to recoup earlier escalations in costs. Through the last six weeks of 2005, commercial contractors reported modest increases in materials costs, often citing increases in the prices for fuel and drywall. Only slight increases in some firms' workforces were reported.

Transportation

Demand for trucking and shipping services remained strong throughout the last six weeks of 2005, and stronger than at this time a year ago. Higher fuel costs continued to concern contacts, even though trucking companies have been able to maintain their surcharges. Many contacts also reported that their firms intend to increase base rates beginning in 2006. Carriers continued to report difficulty attracting and retaining drivers, however few firms planned to increase wages. Some acquisitions are reportedly being undertaken to add additional drivers to firms. Capital spending in the industry is expected to stay strong given changes in emissions regulations that will take effect in 2007.

Banking

Through the last six weeks of 2005, District banks saw an increase in the loans to their commercial clients, with lending related to real estate remaining especially strong. By contrast, consumer borrowing, across an array of categories, was flat for most banks in the District. Deposit growth also remained modest for most banks, though some contacts saw an improvement in the demand for certificates of deposit. Credit quality continued to be characterized as strong among both consumer and commercial borrowers. Contacts also reported that their commercial clients were confident about the upcoming year.

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Fifth District--Richmond

Fifth District economic activity continued to expand at a solid pace in late November and December, despite somewhat slower growth in the manufacturing and housing sectors. District services businesses noted steady increases in revenues, and retailers reported generally strong holiday sales. The manufacturing sector lost some momentum, however; output growth slowed in December as furniture, lumber, and textiles production weakened. District housing markets remained generally strong, despite slowing home sales in some areas and flattening home prices in many areas. In the financial sector, bank lending rose at a more modest pace as residential mortgage lending barely rose. Reports on tourism were upbeat; hoteliers in both coastal and mountain areas said that their bookings remained strong. In District labor markets, employment growth was generally modest. Business contacts said that most goods and services prices rose at a slower pace, in part because of moderating energy prices. In agriculture, late fall harvesting was hampered by cold temperatures and heavy precipitation in some areas, but the rainfall benefited winter grain crops.

Retail

Retail sales growth picked up in the weeks since our last report. District retailers reported generally solid holiday merchandise and gift card sales and expected the redemption of gift cards to boost their sales in early 2006. Contacts at grocery stores also reported solid growth in sales. Automobile and light truck sales strengthened at dealerships in a number of areas, but sales of some other big-ticket items, especially furniture, were soft in many areas. Retail hiring was lackluster, but wage growth remained strong. Price growth in the sector eased.

Services

Services firms reported continued solid growth in their revenues. Trucking companies and construction subcontractors, for example, generally reported stronger revenue growth since our last report. In addition, health care, professional, scientific, and technical services contacts reported upticks in revenue growth. In labor markets, growth in employment and wages slowed somewhat. Price growth in the services sector moderated as well.

Manufacturing

District manufacturing activity grew more slowly in the weeks since our last report. Factory shipments and new orders expanded at a solid pace in November but were essentially flat in December. Although producers of electronic equipment and rubber and plastics products reported that activity increased, these gains were partially offset by weakness in the furniture, lumber, and textiles sectors. A furniture manufacturer in Virginia reported a decline in shipments and new orders, adding that his company was closing its largest plant because of business lost to overseas competitors. Several contacts in the lumber industry reported falling new orders in December. A contact at a West Virginia lumber company noted, "Everyone's [customers'] inventory is too high--they are not purchasing lumber." A counterpart in North Carolina said that new orders were down because of bad weather in markets in the Northeast. On a brighter note, a plastics producer in North Carolina told us, "We are optimistic; sales and shipping levels are good, and new orders continue to come in." Prices of both raw materials and finished goods rose at a more moderate pace in December.

Finance

District bankers reported that lending activity grew more slowly since our last report. Residential mortgage lenders said that decelerating housing markets combined with the typical seasonal lull slowed growth in home mortgage lending in December. District bankers reported that commercial lending leveled off. A contact in Charlottesville, Va., noted "commercial lines are down a bit," and said that he expected sales of large dollar investment property to weaken. But most commercial bankers were optimistic about business in 2006; a lender in Richmond, Va., said that he expected commercial lending to increase by ten percent this year.

Real Estate

Residential real estate agents reported that while housing markets remained generally strong, growth in activity cooled in late November and December. A Richmond, Va., agent said that home sales declined in December and that houses were staying on the market longer there. Agents in Fairfax, Va., Virginia Beach, Va., and Washington, D.C., also reported slowing sales. Still, agents in several areas were quick to point out that housing markets retained considerable strength. A contact in Greenville, S.C., for example, said sales were "outstanding" in November and December--the best in his agency's 40-year history. Comments on home prices also suggested cooling markets in many areas. A Fairfax, Va., agent told us that sellers were now more willing to negotiate on prices, and agents throughout the District said home prices were beginning to stabilize after months of rapid escalation.

Commercial real estate agents reported solid growth in leasing activity since our last report. Contacts in Richmond, Va., and Washington, D.C., said that demand for retail space was particularly strong. An agent in Raleigh, N.C., reported strong growth in office leasing there, in part because "people want to put their money somewhere other than the stock market." Agents across the Fifth District reported little new commercial construction. A contact in Richmond, Va., said "although there are a few planned [commercial] projects, ground has not yet been broken, which is a good thing because it allows us more time to absorb existing space." Commercial rents were steady, but contacts expected further increases as vacant space is absorbed. Vacancy rates in most areas of the Fifth District remained fairly low. An agent from Columbia, S.C., expressed optimism for 2006, in part because he expected more stable interest rates this year.

Tourism

Tourist activity remained strong since our last report. Contacts along the coast told us that warmer-than-normal weather in late December and early January boosted business considerably. A hotelier in Virginia Beach, Va., reported that holiday bookings were much stronger than a year ago, but added that travelers were becoming more price conscious and concerned about high gasoline prices. Reports from mountain areas were also positive--contacts at mountain resorts in Virginia and West Virginia said that they were "packed" between Christmas and New Year's Day.

Temporary Employment

Temporary employment agencies in the District continued to report generally strong demand for workers. An agent in Raleigh, N.C., said that demand typically slackens in the fourth quarter of the year because of the Thanksgiving, Christmas, and New Year holidays, but noted that his agency had received "a lot of job orders" for early 2006. Skilled manufacturing, administrative, and customer service employees were among the most highly sought worker categories across the District.

Agriculture

Colder-than-normal temperatures and abundant precipitation in late November and early December slowed harvesting activity in the Fifth District. In North Carolina, rain and snow brought small grain seeding and corn and soybean harvesting activity to a standstill. But the rain was welcome in many localities--relieving dry conditions in North Carolina and boosting the emergence of winter grain crops there. Small grain crops were reported to be in generally good condition in most areas of the District.

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Sixth District--Atlanta

Most Sixth District business contacts reported that economic activity continued to expand at a solid pace during late November and December. Retail sales were generally positive and met expectations over the holiday season, while tourist activity increased. Housing markets continued to moderate in some areas, whereas manufacturing activity expanded and the demand for freight services remained solid. Reports suggest that regional labor markets continued to firm, with the demand for skilled workers in the construction industry particularly strong. Most business contacts reported difficulty passing on cost increases because of competitive pressures. However, energy surcharges persisted, and higher costs remained a concern in several industries. Storm-related rebuilding was well underway in parts of Mississippi and Louisiana, although activity in the New Orleans area remained focused mostly on cleanup and demolition.

Consumer Spending

Reports from retail contacts were generally positive over the holiday season, with most retailers indicating they achieved sales goals. Strong reports came from luxury retailers and department stores, with the latter sales helped by heavy promotional activity concentrated over the holidays. Many retailers in Alabama, Louisiana, and Mississippi said they had very strong results as customers continued to replace hurricane-damaged items. The majority of retailers reported that they were satisfied with inventory levels. Merchants' outlook for first-quarter sales was largely positive. Vehicle sales were mixed in December. Domestic dealers reported weak demand as modest promotions failed to boost sales, whereas demand for imported vehicles remained strong. Sales in storm-damaged areas were boosted by purchases of replacement vehicles.

Real Estate

Single-family housing activity moderated, including some Florida markets, but remained at high levels overall. Realtors and builders in Florida reported that inventories had increased as sales of existing and new homes slowed in December. According to homebuilders, construction and repair work remained brisk in Louisiana and Mississippi. Most contacts outside southern Louisiana and Mississippi anticipate home construction and sales will moderate further over the next few months, but will remain at healthy levels. District commercial real estate markets continued to improve modestly. However, construction was reportedly being limited by higher material prices and ongoing labor shortages.

Manufacturing and Transportation

Overall, reports from the manufacturing sector were positive during late November and December. Several storm-damaged operations along the Gulf Coast have restarted. For example, one of the largest sugar refineries in the nation located near New Orleans has reopened following extensive repairs. Most oil refineries affected by the hurricanes were back on line, and one petroleum refiner noted increasing production and employment. However, gas processing remains disrupted, with repairs proceeding slowly. Automotive suppliers continued to locate or expand close to the newer assembly plants in the District. Positive reports also came from the building materials and the defense and aerospace industries. Weakness in the textile industry and some segments of the automobile industry were noted. Trucking contacts reported that freight demand remained solid. However, many noted lower margins because of high fuel costs. Driver shortages are still a major concern. For instance, activity at the Port of New Orleans was reportedly limited by a shortage of truck drivers.

Tourism and Business Travel

Information from the tourism sector was positive in November and December. Contacts at Florida theme parks reported a good holiday season and were optimistic about the near-term outlook. In South Florida, international visitor counts remained strong and hotel occupancy rates were up from a year ago. Reports suggest that major hotels in Nashville are also doing well. The Georgia Aquarium in Atlanta opened in late November and sold over 200,000 annual passes in its first month of operation. A large convention has recently recommitted to New Orleans, and reopened casinos in Biloxi added to optimism regarding the recovery of the tourism industry in those areas.

Banking and Finance

Financial activity remained generally positive. There were some reports of slowing in refinancing and residential loan applications, with more refinancing activity concentrated among homeowners with adjustable rate or interest only mortgages. Commercial and industrial financing activity was mixed. In Florida, residential construction loan demand was said to be slowing, but remained at high levels.

Employment and Prices

Payrolls continued to expand during late November and December, and the demand for both skilled and unskilled labor was strong, according to most contacts. Retail contacts noted more difficulty filling seasonal positions than a year ago. Some construction companies, mainly in storm-affected areas, reported that there is an extreme shortage of carpenters, brick masons, sheetrock-installers, plumbers and electricians. Some workers were said to be relocating to the Gulf Coast to take advantage of job opportunities. Nonetheless, a general shortage of workers in New Orleans continued to be a problem that was causing many businesses to operate with abbreviated hours. In Florida, a shortage of workers for the winter tourist season was noted.

Most businesses reported that competitive pressures were limiting the pass through of cost increases to customers. However, energy prices remained a concern for several industries. Contacts noted that suppliers of petroleum-based products and services continued to apply surcharges, and most indicated no rollbacks in energy surcharges. Some large vendors have said that they plan to keep surcharges, but adjust them based on energy prices. The plant manager of a major chemical facility reiterated that increases in natural gas prices, a major input in their operations, have resulted in higher prices for petrochemicals. Some commercial builders reported that materials prices are increasing faster than they can be passed along, and are concerned that some projects could be delayed or cancelled as a result.

Natural Resources and Agriculture

Weather conditions were generally favorable for fieldwork and harvesting in most areas of the District. Florida's citrus industry received a boost from higher orange juice prices. Poultry industry contacts reported weaker overseas demand because of Bird Flu concerns.

Oil and natural gas production continued to recover in the Gulf of Mexico. Oil production has returned to over 70 percent of pre-storm levels and natural gas production is back to over 80 percent of normal production. Contacts report significant increases in exploration planned for 2006.

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Seventh District--Chicago

Economic activity in the Seventh District continued to expand at a moderate pace during December. In general, spending by consumers and businesses increased at a modest

pace. Employment expanded further in most locations and industries. The manufacturing sector expanded again, with the pace of growth firming in some industries. Residential construction and real estate activity tapered off, while commercial real estate activity increased at a slower pace than in the previous reporting period. Mortgage demand was down, and the expansion in commercial lending continued to slow. Cost and price pressures remained firm in December. Farmers expressed concern about the lack of snowfall in the District, which deepened worries about spring soil moisture levels and contributed to a shift in planting intentions from corn acres to soybean.

Consumer Spending
Consumer spending continued to increase modestly in December. Most District retailers said that holiday sales recorded low single-digit increases from last year and that these gains generally were in line with their expectations. The only exceptions were retailers in Michigan, who said that sales increased less than planned. Electronics and luxury items, such as jewelry and furs, sold well. All retail contacts noted strong growth in sales of gift cards. Retail inventories were at desired levels. Auto dealers in northern Indiana reported a pickup in demand in December, while dealers in Wisconsin said that sales remained slow. A restaurant chain said that sales in the Midwest increased at a faster rate than in the previous reporting period.

Business Spending
Business spending and hiring expanded at a gradual pace again. District firms continued to increase capital spending. Most were purchasing new machines and equipment to increase productivity, though one heavy machinery supplier reported new plans to expand its factory space. Dry goods shipping remained strong after improving markedly in the third quarter. Overall labor market conditions changed little: Employment continued to increase in many locales and in a wide range of sectors. Shortages of truck drivers and skilled manufacturing workers persisted. One manufacturer said that it was refocusing on training current workers to fill higher-skilled job openings rather than recruiting new workers. Staffing services firms reported that temporary hiring picked up steadily again in most areas in the District, though Detroit continued to experience stagnant demand. In contrast, layoffs were reported by some auto suppliers, pharmaceutical makers, and retailers, and one bank said that it was considering staffing reductions in mortgage underwriting.

Construction and Real Estate
Construction and real estate activity was mixed by both location and market segment. Residential activity was gradually slowing from record levels. One Chicago-area homebuilder noted that suburban homes were taking longer to sell and that builders were increasing incentives to close deals, while a Realtor in Wisconsin reported taking a less aggressive stance on list prices. Commercial construction and real estate continued to expand, but at a slower pace than in the previous reporting period. Activity picked up in Indiana, Wisconsin, and mid-Michigan, but was flat in the Chicago area. Office vacancy rates fell in Indiana but were steady at high levels in Chicago and southeast Michigan.

Manufacturing
The manufacturing sector strengthened in December. Nationwide light vehicle sales picked up at the end of the year, and one contact noted that the gain did not reflect a boost in fleet sales to achieve end-of-year sales goals. Vehicle production plans for the first quarter called for a small increase in output from the same period last year. Orders and production of heavy trucks rose in December. Activity in the construction equipment industry continued at a brisk pace. Industry participants were optimistic about the outlook for 2006, saying that strong demand for nonresidential building would offset any slowdown in housing. Demand for farm tractors bottomed out. Construction and agriculture equipment inventories were at desired levels. District toolmakers reported solid orders growth and expressed confidence about the outlook for 2006. Conditions in the steel industry continued to be strong, with growth in orders across several end-user markets. Steel inventories were below desired levels, and they were being rebuilt.

Banking and Finance
Lending activity moderated further. Bankers noted declines in applications for both home-purchase and refinancing mortgages. Usage of home equity lines of credit remained stable. Reports on mortgage credit quality were mostly favorable, though one Chicago-area banker expressed concern that home equity loan delinquencies continued to drift up. Commercial lending continued to expand in December, though at a pace that was slower than earlier in the year. One banker said that business use of credit lines remained well below historical norms. Commercial credit quality was in good shape, with a smaller share of non-accruing loans and charge-offs than earlier in the year. Contacts noted that competitive pressures in commercial lending persisted, but they did not report a further easing in standards and terms or a narrowing of interest rate spreads.

Prices and Costs
Price and cost pressures remained firm in December. Several contacts noted lower fuel costs. Still, some contacts said that diesel prices had not come down as much as other fuel prices, and one shipper said that fuel surcharges remained very common. In addition, prices for plastics and other petroleum-related products increased further. Sugar, copper, aluminum, and corrugated cardboard prices all were up since the last report. Finished steel prices stabilized at high levels, though scrap prices fell. Carpet prices declined some after spiking in the fall. A retailer said that it was budgeting for a larger increase in its cost of goods sold in 2006 than it experienced in 2005. Reports on wages were mixed but generally suggested some intensifying pressures. A staffing firm said that clients were growing more likely to increase wage offers to find workers for certain high-skilled jobs. A number of hiring managers reported that they were planning larger increases in salaries for both new hires and existing workers compared with 2005. In contrast, trucker wage gains reportedly slowed, despite persistent labor shortages.

Agriculture
Farmers stored as much of the 2005 harvest as possible, which contributed to higher corn and soybean prices in December and helped ease crop transportation problems. Farmers responded to high diesel prices by reducing the number of trips required for each field. For example, many invested in no-till equipment, which does not require the fields to be plowed before planting. A lack of snowfall raised concerns about potential moisture conditions this spring and complicated planting decisions for many District farmers. Farmers currently intend to plant relatively more soybean acres versus corn, though some thought that further corn price increases would moderate the shift. With stable hog prices and higher cattle prices, livestock producers generally at least covered their costs of production. There were mixed signals regarding farmland values, with more contacts reporting that values have stopped rising and leveled off.

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Eighth District--St. Louis

Economic activity in the Eighth District expanded modestly since our previous survey. The services sector continued to grow. Reports in manufacturing continued to be mixed. Home sales continued to increase throughout the District, while commercial and industrial development continued to expand. Lending activity at a sample of small and mid-sized District banks increased slightly from mid-September to the end of November.

Manufacturing and Other Business Activity
Reports from manufacturing contacts continued to be mixed. Several manufacturers reported plant openings and expansions and a similar number of contacts reported plant closings and workforce reductions. Firms in the chemical, transportation equipment, and paper industries announced plans to open new facilities in the District. Firms in the chemical, machinery, electrical equipment, and commercial printing industries reported plans to expand facilities and hire additional workers. Despite this growth, contacts in the wood product, apparel, engine, and packaging industries reported plans to close plants and lay off workers. Several firms in the motor vehicle industry reported plans to discontinue production lines or temporarily idle workers. Some firms in the electronics and fabricated metal products industries reduced employment as production shifted to Mexico.

The District's services sector continued to expand in most areas since our previous report. Contacts in the wireless telecommunications industry experienced solid customer growth and high sales volume. Despite overall positive growth, some contacts in the utility and publishing industries announced plans to reduce workforces. Most District retailers characterized holiday season sales as "a little bit better than last year." Some retailers reported double-digit sales increases in November compared with the same month in 2004. December sales decreased slightly relative to November, although they increased relative to year-ago levels. Strong-selling items included discount items, electronics, hardware, and clothing. District auto dealers reported sluggish sales during November and December compared with the same months one year ago, despite a slight pick-up in December sales relative to November. Used vehicle sales remained steady and sales of sport utility vehicles continued to lag.

Real Estate and Construction
November 2005 year-to-date home sales increased throughout the Eighth District compared with the same period in 2004. Sales increased by 1 percent in St. Louis, by 9.4 percent in Memphis, by 9.7 percent in Louisville, and by 3 percent in Little Rock. November 2005 year-to-date single-family housing permits were on the rise in most areas. Compared with the same period last year, permits rose over 1 percent in St. Louis, over 9 percent in Memphis, and over 10 percent in Little Rock. However, year-to-date permits fell over 4 percent in Louisville.

Commercial and industrial development continues to expand throughout the District. In Memphis, contacts report that construction is underway on a new biotech research park. In St. Louis, contacts report that construction is slated to begin in early spring on a 600-acre commercial park. Although contacts in northern Mississippi note that November year-to-date commercial development remains below last year's levels, they report that a 325-acre industrial park is planned for 2006. Contacts in Louisville report that nearly 4 million square feet of new industrial space is currently being constructed in Jefferson and Bullitt counties. In southern Indiana contacts report that government construction remains steady.

Banking and Finance
Total loans outstanding at a sample of small and mid-sized District banks showed a modest 0.5 percent increase from mid-September to the end of November. Real estate lending, which accounts for 71.7 percent of total loans, increased 0.4 percent. Commercial and industrial loans, accounting for 17.4 percent of total loans, increased 2.3 percent. Loans to individuals, which account for about 5.3 percent of total loans, fell 0.5 percent. All other loans, roughly 5.6 percent of total loans, decreased 3.2 percent. Over this period, total deposits at these banks increased 1.4 percent.

Agriculture and Natural Resources
December precipitation levels were below normal in most of the District, causing drought conditions to persist in some areas. As of early January, drought conditions continued to be severe and even extreme in western Arkansas. Recent warmer weather helped the winter wheat crop, which is generally in fair or good condition. Year-to-date bales of cotton ginned (separated from the seed) as of mid-December were up 4 percent compared with the same period in 2004; Mississippi had 6 percent fewer bales ginned, while Arkansas, Missouri, and Tennessee all had more bales ginned than last year. Total commercial red meat production increased by 3 percent in November over year-earlier levels, and the total weight of young chickens slaughtered was 2 percent higher for the same period.

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Ninth District--Minneapolis

The Ninth District economy grew moderately since the last report. Increases in activity were noted in consumer spending, manufacturing, and commercial real estate. Meanwhile, energy and mining were stable at a high level and construction was steady. Tourism and agriculture were mixed, while residential real estate softened. Employment levels increased slightly since the last report. Wage increases were moderate. Significant price increases were noted for heating costs, some manufacturing and construction materials, and health insurance.

Consumer Spending and Tourism
Overall holiday retail sales posted moderate growth. A major Minneapolis-based retailer reported same-store sales up almost 5 percent in December compared with a year ago. Retailers in western Montana were generally upbeat; a mall manager in Montana described sales and traffic during December as excellent, particularly the week before Christmas. Sales at a Minneapolis area mall were up about 5 percent during December compared with a year ago; the manager noted that it wasn't a stunning holiday, but not as bad as he had expected when fuel prices were so high. Holiday sales at another Minneapolis area mall were good, but jewelry sales were a little soft, according to the manager. A St. Paul area mall had strong traffic and sales the two weeks before and the week after Christmas. The number of gift card sales was generally higher than a year ago, including a 45 percent increase in gift card sales at a Montana mall.

Car and truck sales during late November and December have been quite slow in North Dakota, according to a representative of an auto dealers association. Overall, November and December motor vehicle sales were soft in Montana, said a representative of an auto dealers association.

Winter tourism was mixed, with several ski areas reporting strong activity; however, after a solid start for snowmobiling, warm weather has recently scuttled many trails. Ski resorts in Montana reported deep snow pack and solid numbers of skiers. In the Black Hills of South Dakota, winter tourism activity was up 40 percent from last winter's slow season, according to a tourism official. While ski hills reported strong sales during the holidays in the Upper Peninsula of Michigan, recent warm weather has slowed snowmobiling in many parts of the Upper Peninsula and northern Wisconsin.

Construction and Real Estate
Overall construction was steady, with commercial construction generally outpacing residential. A survey of Minnesota general contractors performed by an industry association found that 85 percent expect their business to be steady or increasing in 2006. Developers recently announced plans for a $72 million business park in suburban St. Paul. Commercial construction is strong in Sioux Falls, S.D., which ended 2005 with what will likely be a record year. However, November residential building permits in Minneapolis-St. Paul were down 3 percent from high levels a year earlier.

Commercial real estate remains healthy. Industrial absorption in Minneapolis-St. Paul for 2005 was three times as high as the previous year, moving the vacancy rate down to 13 percent at year-end, with growth predicted to continue. A Minneapolis commercial real estate firm reported a decrease in office vacancy and a five-year high in leasing demand. However, residential real estate continued to cool off. In Minneapolis-St. Paul, home sales started to slide at the end of December and listing times increased. A Realtor in Fargo, N.D., reported that the housing market there has slowed since the warmer season, but is about as active as a year ago.

Manufacturing
Manufacturing activity expanded. A December survey of purchasing managers by Creighton University (Omaha, Neb.) indicated growing manufacturing activity in the Dakotas and Minnesota. A bank director noted that manufacturing activity is booming in Sioux Falls; for example many cabinetmakers were working at full capacity. A metal part producer in Minnesota is enthusiastic about orders and profitability and plans to add capacity. A Montana truck body manufacturer is expanding production. The president of a western Wisconsin equipment maker reported that activity was "really busy." The expansion of the wind power industry is boosting district wind tower component manufacturing.

Energy and Mining
Activity in the energy and mining sectors was stable at a high level. Oil and gas exploration and production were about level from mid-November through late December. Expansion of the district wind power and ethanol industries continued. A Montana gold mine that halted strip mining continues to process low grade ore. Nearly all open mines in the western portion of the district were producing at near full capacity, and the outlook for production in 2006 "looks quite good," said a Montana mining official. Taconite mines in northern Minnesota and the Upper Peninsula continue to operate at full capacity.

Agriculture
The agriculture sector was mixed. Soil moisture conditions improved across much of the district. The opening of beef exports to Japan aided district cattle producers. However, Minnesota was stripped of its bovine "tuberculosis free" status as several infected herds were found in the northwestern portion of the state. Many producers are fretting over higher input costs of fertilizer, fuel, and machinery.

Employment, Wages, and Prices
Employment grew slightly since the last report, with optimistic signs for future hiring noted. Nonfarm employment levels in district states were 1.2 percent higher than a year earlier in November. According to the St. Cloud (Minn.) Area Business Outlook Survey, 45 percent of respondents expect to hire workers during the first half of 2006; only 4 percent anticipate reducing worker levels. Results from a survey by a temporary staffing agency showed that 29 percent of respondents plan to hire more workers during the first quarter in Minneapolis-St. Paul, while 9 percent expect to reduce staff.

Wage increases remained moderate. A career center administrator in South Dakota noted that the availability of qualified entry-level employees has tightened and that while wages have climbed steadily, they have not increased by "leaps and bounds." A machinist strike at a packaging equipment manufacturing plant in northwestern Wisconsin recently ended with workers agreeing to concessions, including pay cuts and an increased share of insurance premiums.

Significant price increases were noted in heating costs, some construction and manufacturing materials, food, and health insurance. The cost for heating homes in Minnesota during January is expected to be up 38 percent from a year earlier. Bank directors noted significant price increases in freight carrier rates, cement, PVC pipe, fertilizer, and heavy equipment tires. The Wisconsin Farm Bureau Federation reported that during 2005, overall food costs increased 4 percent compared with a year earlier. A recent survey indicated that costs for health benefits increased 9 percent in Wisconsin during 2005. Diesel fuel prices decreased from peak levels in October, but at year-end were still 50 cents per gallon higher than a year ago. Minnesota gasoline prices in the beginning of January were 20 cents per gallon higher than at the end of November and about 45 cents higher than a year ago.

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Tenth District--Kansas City

The Tenth District economy expanded moderately in the period from late November to early January. Consumer spending and manufacturing activity continued to rise at a solid pace, and labor markets showed further firming. Commercial real estate activity improved slightly, while residential construction held steady at high levels. Energy activity also remained strong, but dry weather caused problems in the agricultural sector. Price pressures were largely unchanged but higher than in the summer, while wage pressures remained low.

Consumer Spending
Consumer spending grew moderately during the holiday season. Retailers, mall managers, and restaurants reported that sales were higher than a year ago, although several contacts noted sales did not meet their expectations. Sales of jewelry and electronics were reported to be strong by many contacts, while women's apparel sales were said to be weak at some stores. Most store managers were pleased with inventory levels and expect solid sales in the months ahead. Auto dealers reported that sales during the period from late November to early January were generally flat and remained well below year-ago levels. Sales of large trucks and SUVs continued to be characterized as particularly slow, and most contacts expect overall sales to remain sluggish in coming months. For the most part, dealers were satisfied with their current level of inventory. Travel and tourism contacts reported that activity was generally above year-ago levels. Traffic was higher than a year ago at most airports across the district, and many hotels reported higher occupancy rates than during the same period last year. Most Colorado ski resorts reported having a strong holiday season, while visits to resorts in New Mexico were below average due to a lack of snow. Tourist activity is expected to remain solid in most parts of the district in the months ahead.

Manufacturing
Manufacturing activity in the district expanded solidly in the period from late November to early January. Plant managers generally reported increases in production and orders from the previous survey. Capital spending also remained strong, and factory activity is expected to continue to grow in the months ahead. Contacts reported that some materials, such as organic chemicals and certain types of steel, continued to be difficult to obtain in the aftermath of the hurricanes. However, most purchasing agents are optimistic that these availability problems will be resolved in the near future.

Real Estate and Construction
Residential construction remained strong in the period from late November to early January, and commercial real estate activity showed further signs of improvement. Home builders reported that starts were generally unchanged since the previous survey and well above year-ago levels. Residential construction is expected to remain strong in most areas in the months ahead. Several builders reported difficulties obtaining some materials and said availability may continue to be a concern in the near future. Residential real estate agents said that home sales were flat or down slightly from the previous survey, but most agents expect home sales to pick up slightly in coming months. Inventories of unsold homes were said to be high in several markets. Year-over-year home price growth remained modest in most of the district, although a few areas did experience significant appreciation during the past year. For the most part, real estate agents expect moderate growth in home prices heading forward. Mortgage lenders reported a decline in demand for both home purchases and refinancings. Lenders expect demand for home purchases to rebound somewhat in the months ahead, but refinancings are expected to remain soft. Commercial real estate activity in the district improved slightly since the last survey. Office vacancy rates either held steady or edged down. In addition a higher fraction of contacts than in the previous survey expected office markets to improve in the months ahead.

Banking
Bankers reported that both loans and deposits edged up since the last survey, leaving loan-deposit ratios unchanged. Demand rose slightly for commercial and industrial loans and commercial real estate loans, while demand fell somewhat for consumer loans and home mortgages. Demand for home equity loans and residential construction loans was flat. On the deposit side, transactions accounts and large CDs increased slightly, while other types of accounts held steady. Nearly all respondents increased their prime lending rates since the last survey, and most respondents also raised their consumer lending rates. Lending standards were unchanged.

Energy
District energy activity remained strong during the period from late November to early January. The count of active oil and gas drilling rigs held steady in the region and remained well above year-ago levels. Many contacts continued to report that shortages of rigs, equipment, and workers were constraining drilling activity. Contacts in Oklahoma did not expect the wildfires in that state to have much of an impact on exploration and production. Firms throughout the district expect to increase drilling heading into spring.

Agriculture
Agricultural conditions across the district deteriorated somewhat during the period from late November to early January. Dry weather across much of the district eroded some of the protective snow cover from the winter wheat crop and put pastures under severe stress. Recently, wildfires have exacerbated adverse pasture conditions and taken a toll on hay supplies in Oklahoma. With dry weather expected to continue through the winter, contacts predict that many affected producers will draw down herds in the coming weeks and months. High fuel and fertilizer costs and lower crop prices are also a concern heading forward.

Labor Markets and Wages
Labor markets continued to firm in the period from late November to early January, but wage pressures remained modest. There were considerably more hiring announcements than layoff announcements in the district since the previous survey. A number of large retail stores announced plans to expand distribution centers in the district, and several engineering firms also plan to add workers. The percentage of contacts reporting labor shortages edged down from the previous survey. However, several types of workers were said to be difficult to find, including truck drivers, auto mechanics, oil and gas workers and unskilled manufacturing workers. The percentage of firms reporting above-normal wage increases was relatively low and unchanged from the previous survey.

Prices
Price pressures were little changed from the previous survey but remained higher than in the summer. The percentage of manufacturers reporting increases in materials prices eased somewhat, and several contacts reported that the price of petroleum-based inputs had come down after increasing sharply during the fall. However, both the share of manufacturers paying higher input prices and the share charging higher output prices remained very high by historical standards. A substantial number of plant managers continued to expect raw material prices and output prices to rise further in the months ahead. Builders indicated that the cost of materials, including lumber and concrete, continued to rise, and they do not expect these prices to ease for some time. The share of retail stores reporting higher prices than a year ago edged down from the previous survey but remained higher than in the summer. In addition, a larger percentage of retail stores than in the last survey plan price increases in the future.

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Eleventh District--Dallas

Eleventh District economic activity accelerated from mid-November to early January. Energy activity continued to strengthen, although the industry is still cleaning up after the hurricanes. Manufacturing picked up, and demand for business services increased slightly. Construction remained at about the same pace, while most real estate markets improved gradually. Contacts in the financial services industry say credit quality remains good. Dry weather is straining agricultural conditions, but the 2005 cotton crop was one of the largest ever.

Prices
Contacts in many industries expressed concerns about high or rising costs. Increased costs led to higher selling prices at some firms, but many said that stiff competition was limiting their ability to increase prices. Input costs are up for a number of products, including energy, fuel, health insurance, shipping, lumber, paper, metals and property insurance. Prices are up for most construction-related materials. Home builders report higher costs for steel, concrete, copper, roofing and framing, and say that home prices are not rising as fast as they'd like. Agricultural producers expressed concern about high fuel, fertilizer and chemical costs.

Energy prices remain high by historical standards. Cold weather in the northern United States led to gains in heating oil and natural gas prices in December. Reduced consumption and warmer weather pushed natural gas prices down sharply in January. Natural gas and crude oil inventories are high. After falling steadily through mid-December, retail gasoline prices were pushed up at the end of December by rising crude prices and fears that MTBE regulation could reduce supply.

Prices are lower for most petrochemical products, including styrene, polystyrene, polypropylene, bottle resins, benzene, and ethylene glycol. Contract ethylene prices have held up, but spot prices are down significantly.

Labor Market
The labor market continues to slowly tighten, with more reports of hiring and rising wages. Workers with specialized skills remain in short supply, such as to supply the energy industry, trucking and some areas of manufacturing and information technology. Temporary service firms say a very high percentage of workers are obtaining full time positions from initial short term contracts.

Manufacturing
Manufacturing activity strengthened. Unusually warm, dry weather led to very strong demand for construction-related products, such as brick and stone. Demand is up for fabricated metals compared to last quarter and last year. Primary metals producers reported strong demand, stimulated by home building and exports, and some said inventories were low. Food producers reported little change in sales. Demand for paper and lumber was also unchanged. Lumber producers say inventories are up.

High-tech manufacturers reported steady to slightly higher growth in orders and sales since the last survey. Semiconductor orders accelerated some, according to contacts, who say the outlook has improved. Semiconductor inventories are lean, and replenishing of inventories over the next several quarters is expected. Communications equipment manufacturers reported steady growth in orders.

Petrochemical demand and prices weakened from very strong levels. Downstream processors did not want to build inventory because they sense price reductions ahead, while producers held back on building inventories for year-end tax purposes. Significant levels of imports have been entering the country for polyethylene, bottle resins and other plastics. Contacts expect imports to continue as a hedge against hurricane-like disruptions.

Refinery margins, which were unusually high, began a sharp and consistent decline in early October that continued through November. Margins stabilized at relatively high levels in December. Gulf Coast capacity utilization rose from 78 to 85 percent in recent weeks. Two refineries are still out of operation due to hurricane damage and three others are operating on at a reduced level. Suppliers to the industry say most refineries are operating again but continue to struggle to stay up and to run at full capacity.

Services
The service sector appears to have accelerated slightly. Accounting firms still report very strong activity, and demand has increased for firms that supply temporary workers. Temporary agencies say new business is mostly to supply firms that manufacture durables, which they attribute to business attracted by the low cost of doing business. Demand at legal firms has been mostly unchanged, with the strongest activity related to transactions, taxation, and real estate. Contacts say work to support transactions in the oil and gas sector has been especially profitable and strong.

Transportation firms reported continued strong demand. Cargo volume is up slightly over the past month, with growth mostly from international demand. Trucking firms say sales to the private sector are up. Wage and fuel costs have risen faster than shipping rates, they say, particularly for contracts with state and federal government where some rates were set three or four years ago.

Railroads report higher demand, with more shipments of coke, motor vehicles, crushed stone and ethanol. Contacts say shipments are lower for chemicals and grain, which they attribute to continued hurricane disruptions. There have also been fewer shipments of wood and metallic ores. The industry is working near capacity, and there are plans to add rail lines and purchase locomotives this year. Airlines report that demand has increased and is growing faster than capacity domestically. This has allowed carriers to increase prices and profits.

Retail Sales
Retail sales have been reported as "good" but not "great." Sales continued to be strong in areas that have become home for hurricane evacuees. Contacts say that price competition is fierce, cutting into profits. A few retailers reported pockets of high inventory, but most said inventories are at good levels, although some retailers discounted to clear the merchandise. Contacts have now turned their focus to gift cards, which they hope will be used to purchase goods at full price leading to greater profit margins. Retailers expressed concern that new rules requiring higher minimum credit card payments will restrain spending by already strapped consumers. Auto dealers report that sales have improved some from a sluggish level.

Construction and Real Estate
Office markets continue to gradually improve. Vacancies are edging down, and there are reports that concessions are being reduced or eliminated. Commercial construction continued to rise. Industrial demand and construction was unchanged. New home demand is still strong, according to builders, who said prices have not risen as much as they would like despite increases in raw material costs. Demand for existing homes was still strong, with sales up over last year's record levels in most major metros. Demand for apartments grew steadily over the past six weeks.

Financial Services
Financial services respondents continued to report good credit quality and intense competition in pricing loans. Deposit growth is pretty strong, they say, but there is increased pressure to raise interest rates on deposits.

Energy
Energy activity has been strong. The domestic rig count was unchanged, but this was largely due to capacity constraints. There are still shortages of labor, equipment and materials, such as sand for fracturing and cement. Oil service firms report extremely strong demand and long backlogs. Equipment manufacturers are encouraging customers to order early and carry large inventories.

Day rates for rigs in the Gulf of Mexico are up sharply, partly because of hurricane-related losses but also because some rigs are leaving the Gulf for more lucrative markets overseas. The rig count is rising outside the U.S., and contacts say that service demand has been increasing rapidly because this drilling is complex and expensive.

Repairs are still bringing production back on line following the hurricanes. Twenty six percent of oil production in the Gulf of Mexico was off line on December 22, down from 46 percent on November 15. Nineteen percent of natural gas production was out of service on December 22, down from 37 percent on November 15. The recovery is expected to slow over the next several months, because several large outages will take months more to repair.

Agriculture
Conditions are very dry and subsoil moisture is low in parts of the District. Poor water supplies and pasture conditions have led some ranchers to reduce herds. Many ranchers are purchasing feed grains for their livestock because corn production was down 7 to 10 percent from the prior year. The Texas 2005 cotton crop was large, thanks to spring rains, hot weather and eradication of the boll weevil. Citrus producers benefited from high selling prices following wide spread hurricane damage to the crop in Florida. Ranchers are pleased that Japan lifted its ban on U.S. beef imports, although they expect a delay before producers regain market share. Japan had been the leading importer of U.S. beef.

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Twelfth District--San Francisco

The Twelfth District economy continued to expand at a solid pace during the survey period of late November through the beginning of January. Price inflation was modest overall, helped in part by recent declines in energy prices. Contacts reported moderate wage increases in general, with more rapid increases reported for workers with specialized skills in selected industries. Retail sales expanded during the holiday season, and service providers reported further demand growth. Manufacturers and agricultural producers saw strong demand for their products. Activity in residential real estate markets generally remained at high levels but slowed in some areas, while demand for commercial real estate improved further. District banks reported steady loan demand overall and very good credit quality.

Wages and Prices
Contacts reported that upward price pressures diminished somewhat, as prices for energy and related products receded from previously high levels. Construction materials remained in short supply in some areas, keeping construction costs at elevated levels or raising them further, and prices on selected manufactured goods rose significantly of late. In most sectors, however, vigorous competition and continued gains in production efficiency reportedly held down increases in final prices, keeping overall price inflation modest.

Wage increases reportedly were moderate on net, in the range of 3 to 5 percent on an annual basis. However, the pace of wage growth was substantially more rapid for workers with specialized skills in the financial, construction, and health-care services sectors. Employers' costs for employee benefits, particularly for health insurance, continued to rise more rapidly than wages.

Retail Trade and Services
District retailers reported generally solid performance for the holiday season as a whole, with sales up in dollar terms and in unit terms relative to last year. Sales growth was evident for most retail market segments, with department stores and establishments specializing in luxury products performing especially well. Contacts noted that the extent of holiday season discounting was about the same as last year. Overall, most contacts reported that holiday sales met or slightly exceeded expectations, leaving retail inventories generally in balance. Sales of new automobiles improved slightly in the wake of very weak performance during the previous survey period. According to an Idaho contact, inventories of used vehicles were unusually low and prices rose "dramatically," as available supply was redirected to areas of the country where vehicles were damaged by the September hurricanes.

Service providers reported continued strong demand. Sales grew further in the food and beverage, health-care, media, and transportation sectors. District travel and tourism activity remained vigorous, especially in Hawaii, where growth in visitor numbers and spending has been setting records and hotel occupancy rates have continued to rise.

Manufacturing
District manufacturers reported strong demand for their products during the survey period of late November through the beginning of January. Orders and sales of semiconductors grew further and capacity utilization remained at high levels. District makers of machine tools and industrial equipment saw robust demand and consequently operated at or near full capacity. Makers of commercial aircraft expanded employment further during the survey period, and they continued on a rapid production path to meet the surge in orders experienced in 2005. Demand remained strong for various building materials manufactured in the District, including wallboard and insulation, although one respondent characterized demand for fabricated metals as "stable but lackluster." District food processors reported steady growth in sales.

Agriculture and Resource-related Industries
Providers of agricultural and resource-related products reported strong demand and generally good supply conditions. Orders and sales grew further for a variety of agricultural products, including various crops and livestock. Prices were largely stable, although one contact noted price fluctuations for specialty produce due to unseasonable weather that affected yields. In the energy sector, District producers of oil and natural gas reportedly operated "near 100 percent capacity" and experienced difficulties and delays in hiring skilled workers and obtaining raw materials; their inventories, however, remained adequate.

Real Estate and Construction
Activity in residential real estate markets continued at high levels but softened in some areas, while demand for commercial real estate increased further. The pace of home construction and sales was high throughout the District, and home prices rose further in most areas. However, these and other indicators, such as time on the market, reflected a slower pace of growth or reduced activity in some areas, notably Southern California and the San Francisco Bay Area. In other areas, residential real estate markets showed little or no sign of cooling, and conditions reportedly heated up further in some markets, such as Oregon and especially Hawaii. On the commercial side, office vacancy rates fell and rents continued to rise in most major markets. Increasing demand for commercial structures offset declining residential construction in some areas, helping to keep construction activity at high levels overall. Consequently, contacts reported scattered shortages and high prices for some construction materials, such as steel and cement, along with difficulties recruiting skilled construction workers in some areas.

Financial Institutions
District banking contacts reported generally steady loan demand and very good credit quality during the survey period. Lending to businesses increased somewhat, while mortgage originations and residential construction loans were stable to down slightly on net. Indicators of credit quality, such as loan delinquencies, have achieved unusually favorable levels in some areas. However, a very competitive environment and narrow interest rate spreads reportedly held down profit margins in the banking sector.

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