July 25, 2007

Summary of Commentary on Current Economic Conditions by Federal Reserve District

Summary

Prepared at the Federal Reserve Bank of Chicago and based on information collected before July 16, 2007. This document summarizes comments received from business and other contacts outside the Federal Reserve and is not a commentary on the views of Federal Reserve officials.

Reports from the twelve Federal Reserve Banks indicated that economic activity continued to expand in June and early July. New York, Richmond, St. Louis, Minneapolis, and San Francisco described the pace of growth as "moderate" while Cleveland and Chicago saw it as "modest." Philadelphia noted that economic conditions improved. Kansas City said the regional economy continued to grow but at a moderating pace, and Dallas characterized its economy as strong but said it decelerated. Boston and Atlanta described business contacts' reports as "varied" or "mixed."

On balance, consumer spending rose at a modest pace, although a number of Districts indicated that sales were mixed or below expectations. Several reports indicated that capital spending increased, and expenditures for most business services continued to rise. Employment increased further in most regions and in many sectors of the economy. Most Districts said that residential construction and real estate activity continued to decline. Commercial construction and real estate markets were generally more active than during the previous reporting period. District reports indicated that manufacturing activity continued to expand during June and early July. Household lending declined in most regions, while commercial and industrial lending expanded at a modest pace. Contacts generally reported ongoing input cost pressures, particularly for petroleum-related inputs, while prices at the retail level continued to increase at a moderate rate. Energy and natural resource activity remained at high levels, or in some instances, rose further. Many Districts described overall wage gains as moderate and/or similar to the previous reporting period. Agricultural conditions varied widely, as the impacts of drought were felt east of the Mississippi River and heavy rains affected the Dallas and Kansas City Districts.

Consumer Spending and Tourism
On balance, consumer spending rose at a modest pace, although a number of Districts indicated that sales were mixed or below expectations Cleveland, Chicago, St. Louis, and Minneapolis all shared the general assessment that consumer spending rose modestly, while Philadelphia said retail sales growth was quite strong in May but "closer to trend" in June. New York, Atlanta, Kansas City, and Dallas reported sales as flat and/or below expectations. The remaining regions described sales as mixed. A number of Districts noted that high gas prices restrained spending; Chicago also noted a negative impact from high food prices, and Dallas mentioned that wet weather depressed sales. Five regions indicated that retail sales of items related to housing--such as furniture and home repair materials--were weak or declining. Retail inventories were generally at desired levels across the country, while Atlanta and San Francisco observed some increases. New vehicle sales in many areas were described as "flat" or "lackluster," although dealers in Philadelphia and Chicago noted some improvement between June and early July. Many Districts commented on the relative strength of demand for fuel-efficient vehicles compared with larger automobiles and of foreign brands compared to domestics.

The majority of reports on tourism were positive. Strong gains were noted in many sections of the New York, Richmond, Minneapolis, Kansas City, and San Francisco Districts. Minneapolis noted an increase in the number of Canadians visiting and shopping in the region, but Boston and San Francisco said that international tourism was down.

Business Spending and Hiring
Several reports indicated that capital spending increased. Firms in New York, Cleveland, and Chicago said capital outlays increased according to plans. Current investment was mixed in Boston; Kansas City said capital expenditures were trimmed slightly during the reporting period but were expected to rebound to prior levels in coming months. Philadelphia indicated that investment plans increased compared with two months earlier.

Reports on expenditures for most business services were generally positive. Several Districts noted strong gains by consulting, advertising, health care, scientific and technical, and telecommunications firms; demand for legal services was reported as mixed or unchanged by the Reserve Banks that commented on it. Philadelphia noted a significant increase in demand for business services from start-up and early-stage firms, and some contacts in the region expected further growth in overall service demand in the coming months. Demand for trucking firmed during recent weeks in Richmond and Dallas; reports in Cleveland ranged from strong growth to softening, while Atlanta and Chicago pointed to declines. Small-parcel shipping volumes were good in the Dallas region, and contacts there also expected a pickup in the future. Rail freight volumes declined in Cleveland and Dallas. Air travel was strong in Chicago and Dallas.

Employment continued to increase in most locations and in many sectors of the economy. Richmond said hiring "intensified," Minneapolis indicated that labor markets tightened, and Atlanta and Dallas said labor markets remained tight. Kansas City said employment expanded at a slower pace than previously. Cleveland reported a slight increase in manufacturing employment over the past six weeks, and Richmond indicated that the weakness in factory payrolls in the region had moderated, while Boston said manufacturing employment was unchanged. Retail hiring was limited to store openings in the Cleveland District. Employment in several service-providing industries increased in five Districts. Demand for temporary workers was strong in Richmond and Minneapolis, while Chicago reported a decrease in billable hours. Seven Districts referred to shortages of skilled workers in several industries including retail, construction, manufacturing, accounting, and engineering. Looking ahead, contacts in the New York report anticipated a moderate increase in manufacturing payrolls and a faster rate of nonmanufacturing hiring in the second half; respondents in the Philadelphia report projected that the rate of hiring in the third quarter would match that of the second quarter; a temporary help agency in the Chicago region expected demand to firm in the second half; and in the Minneapolis District, more firms expected to increase payrolls than decrease.

Construction and Real Estate
Most Districts said that residential construction and real estate activity continued to decline on balance. Many Districts, however, noted increased activity in some individual market locales or segments. Atlanta, Chicago, St. Louis, and Minneapolis said construction decreased. Boston and Kansas City said housing markets remained "soft" and "weak," respectively, while San Francisco indicated that residential markets were weak and had slowed further in some areas. New York said markets were mixed but stable. Two notable exceptions were the Cleveland and Richmond regions, which experienced slight increases in sales. Atlanta said home inventories remained high, as did Dallas (even after a slight decline in the recent period). Inventories increased in Kansas City, but they declined in New York, and contacts in Boston and Cleveland described the number of homes for sale as "normal" and "acceptable," respectively. District reports on home price appreciation were mixed: Boston noted a return to price appreciation and Kansas City indicated slower rates of decline. But Richmond and Chicago reported slower rates of increase or the beginning of declines, and in the Dallas District, some contacts projected a correction in entry-level home prices. Looking ahead, contacts in the Cleveland District were uncertain about how long it would be until the market turned, and analysts in Dallas had revised their housing outlook down. Contacts in Atlanta expected further declines overall, though they anticipated the market in Florida would be flat.

Commercial construction and real estate markets were generally more active than during the previous reporting period. New York said markets strengthened and San Francisco reported continued firming. Cleveland, Atlanta, Minneapolis, and Kansas City indicated small gains in development. Richmond and Dallas described local markets as still "solid" and "robust," respectively. Chicago said the pace of development was steady, and St. Louis said markets were mixed. Richmond and Chicago observed that overall commercial vacancy rates were stable. Office vacancy rates fell in four regions. Demand for industrial space increased in four Districts, while net absorption in the Minneapolis District was negative. Richmond, Kansas City, and San Francisco reported increases in rental rates for commercial space, and New York said that the asking rents for space "continued to soar."

Manufacturing
Most District reports indicated that manufacturing activity continued to expand during June and early July. Richmond said that activity rebounded, and manufacturing appeared to expand in the New York, Philadelphia, Cleveland, St. Louis, Minneapolis, and San Francisco regions. Atlanta and Chicago pointed to general stability in the sector, while Kansas City and Dallas said activity "slowed" and "cooled," respectively. Boston said half of their manufacturing respondents pointed to year-over-year declines while the rest said activity was expanding at "normal" rates.

In most Districts, the increases in demand for factory goods were spread across a number of industries. The sectors consistently mentioned as facing strong demand included fabricated metals, defense-related products, aerospace, rubber, and processed food. A number of Districts noted that strong export demand boosted activity. Cleveland reported auto production had increased and was expected to continue moving higher, and an auto parts maker in the St. Louis region planned to increase output. San Francisco reported generally steady demand for information technology products, but noted that semiconductor sales had increased. Chicago reported stronger-than-expected demand for agricultural machinery and projections of further gains in the second half of the year. In contrast, manufacturers of housing-related products (lumber, stone, glass, cement, appliances, and furniture) typically reported declines. Looking ahead, manufacturers in Boston, Philadelphia, and Cleveland expected activity to increase at a modest pace; the expectations of contacts in the Kansas City region improved; and manufacturers in the New York District expressed broad-based optimism. Cleveland noted that steel service centers expected to maintain or slow shipments in the third quarter, while a steel contact in the Chicago region thought that an inventory build would be needed by the end of the summer.

Banking and Finance
Household lending declined in most regions, while commercial and industrial lending expanded at a modest pace. New York, Richmond, Chicago, Kansas City, and San Francisco noted decreasing demand for mortgages, which in many cases was coupled with tighter underwriting standards. Cleveland indicated that consumer lending was flat to declining. In contrast, Philadelphia and Dallas reported that consumer lending was flat, and St. Louis said loans to individuals rose. Lenders in Philadelphia said it was unlikely they would meet their targets for this year, and bankers in Cleveland noted that they expected mortgage demand to remain weak into 2008. Interest rates on household loans increased in many Districts.

Business lending increased in the Philadelphia, Cleveland, Atlanta, Chicago, St. Louis, Dallas, and San Francisco regions, but lending appeared to be flat in Richmond and Kansas City. Three Districts said commercial real estate loans were a notable source of strength, though New York reported declines in these loans.

Household credit quality deteriorated marginally, while business credit quality remained mostly favorable. New York, Richmond, Chicago, and San Francisco observed higher delinquencies on mortgages and other consumer loans. Richmond reported an increase in commercial loan delinquencies, while Philadelphia said late payments on commercial real estate loans remained low, and Chicago indicated that business credit quality was unchanged. Cleveland and Dallas reported no change in overall credit quality. Deposits were up slightly in St. Louis, flat in Atlanta, flat to down in Cleveland, down in Kansas City, and "difficult to obtain" in Dallas.

Prices and Labor Costs
Contacts generally reported ongoing input cost pressures, particularly for petroleum-related inputs, while prices at the retail level continued to increase at a moderate rate. Notable exceptions were the Richmond District, which reported faster rates of price increases as local businesses passed along higher input costs, and the Kansas City region, which experienced an easing in overall price pressures. Almost every region said that oil and gasoline prices were either rising, high, or "an issue." But the cost of natural gas decreased in the Cleveland and Dallas Districts. Prices of some construction materials, such as lumber and cement, declined in parts of the country. A few Districts reported high prices for metals, notably copper. Trucking firms generally passed along higher fuel costs through surcharges, but shippers were unable to implement any other price increases. Prices of manufactured goods increased or were expected to increase further in the Boston region. But Minneapolis reported that fewer contacts than in the past expected to be able to increase the prices of their products, and Cleveland said wholesale prices were steady. New York indicated that retail prices were steady or increasing modestly, and Kansas City said they were flat or lower. Reports on vehicle incentives were mixed, with Chicago saying they were steady and Dallas pointing to new discounts. Restaurateurs in the Kansas City District expected to raise prices in the future due to the higher cost of fresh foods.

Many Districts described overall wage gains as moderate and/or similar to the previous reporting period. However, many also pointed to significant upward pressure on wages and salaries for in-demand, high-skilled workers.

Energy and Natural Resources
Energy extraction and refining activity continued at high levels in June and early July, with growth reported in four Districts. Deep-water drilling in the Gulf of Mexico and activity in the Kansas City District pushed up demand for drilling rigs, equipment, and personnel. Utilization rates for Louisiana Gulf Coast refineries remained high. The Cleveland and Minneapolis Districts cited the development of alternative energy projects. Mining activity was flat, though near capacity, in the Minneapolis District.

Agriculture
Agricultural conditions varied widely across regions. Above-average heat and a lack of moisture affected the Atlanta, Chicago, Richmond, and St. Louis Districts, while excess moisture impeded wheat and hay harvests in the Dallas and Kansas City Districts. The Atlanta District bore the brunt of an expanding drought, which hurt crop development in the Chicago and Richmond Districts as well. Crop conditions were generally favorable in the Dallas, Kansas City, Minneapolis, and St. Louis Districts. Forage and pastures were bad enough in the Atlanta and Richmond Districts that livestock herds were reduced, whereas pastures and ranges improved in the Dallas and Kansas City Districts. Prices for many agricultural products increased during the reporting period, with corn, hogs, and cattle as notable exceptions. Due to price movements combined with higher feed costs, hog and cattle producers faced tightening margins. Increased exports supported agriculture, particularly in the San Francisco District.

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First District--Boston

Reports from business contacts in the First District continue to be varied. Both manufacturers and retailers cited mixed results when contacted in the first half of July. However, retailers are somewhat more upbeat now than in the last Beige Book report, while manufacturers seem marginally less positive. Consulting and advertising firms report strong demand. By contrast, residential real estate markets remain soft; although median sales prices are rising in some areas, sales volumes continue to decline.

Retail
Retail respondents in the First District report mixed results for the early summer months. Same-store sales range from low double-digit decreases to low double-digit increases year-to-date. Sales of men's apparel, footwear, sporting goods, air conditioners, pool-care and gardening items were strong, while women's apparel sales were soft. One restaurant chain reports a positive uptick in sales in the Boston region. Another restaurant company reports that while same-store sales are still down slightly from a year earlier, sales are turning around. A lumber company reports that sales continue to be off from last year because of the weak local housing market.

Inventory levels remain in line with expectations. Most respondents report energy-related price pressure, with several retailers passing along small price increases to their customers. In addition, dairy, beef, chicken, and liquid sugar prices are all expected to rise. Capital spending plans are mixed, with several retailers putting plans on hold while sales remain soft.

A tourism contact reports that international tourism is weaker than in previous periods, possibly due to rising international tensions and increased security measures. Nonetheless, employment remains strong in the hotel industry.

Overall, most retailers remain cautiously optimistic.

Manufacturing and Related Services
Manufacturers and related services providers headquartered in the First District report that sales and orders were mixed in the second quarter. About one-half of the contacts say business was off from year-ago levels, mostly as a result of weak demand for home construction and renovation products, automotive parts, and consumer goods. In addition, some firms have dropped business lines with weak margins. Most of the remaining manufacturing respondents report that sales are growing at "normal" rates, the same as in recent quarters.

Manufacturers indicate that overall materials costs are stable or rising less than they did in 2006, but they express concern that metals costs remain high or volatile. Some companies foresee possible increases in utility rates as contracts expire. About one-half of contacts say their selling prices are holding stable or decreasing in line with prior trends. The remaining firms mostly indicate that selling prices are up about 2 percent to 5 percent from year-earlier levels, or that they plan such increases by yearend.

Manufacturers and related services providers expect their U.S. headcounts to be little changed in 2007. Average wage and salary increases are remaining in the range of 3 percent to 4 percent, but pay raises typically are higher for skilled personnel in areas such as finance and IT. For the most part, contacts continue to report that labor markets for skilled workers are tight but not problematic. Domestic capital spending plans vary, depending on factors such as product and technology cycles.

Manufacturers express guardedly positive views concerning the outlook for the coming year. For the most part, they expect demand to hold steady or increase at a subdued pace.

Selected Business Services
Most responding First District advertising and consulting firms enjoyed robust demand for their products and services in the second quarter of 2007, with several contacts reporting double-digit year-over-year revenue growth for the quarter. Only one marketing firm has been experiencing "soft" demand over the past three months, with revenues growing more slowly than they expected. Respondents attribute strong growth to expansion in many of the sectors they serve, including healthcare, pharmaceuticals, financial services, technology, and private equity. Consulting contacts observe that demand for services related to operational effectiveness and cost rationalization remains strong. One marketing contact reports rising demand for the interactive aspects of branding, while another notes an increase in demand for the creation and placement of online campaigns.

While two firms are facing downward pricing pressure from clients, two others have been able to increase their selling prices by 5 percent to 10 percent over the last year. The rest have kept their prices relatively constant. With the majority of responding firms either "reengineering" or expanding their workforce, the primary cost concern among respondents is labor. Companies are finding it increasingly difficult to attract and retain quality employees and are seeing upward pressure on wages. Despite these concerns, most contacts are optimistic in their outlook, expecting growth to continue at its current pace for the rest of the year.

Residential Real Estate
Price appreciation may be returning to several New England housing markets. Following flat to declining year-on-year prices in previous months, the median price for single family homes sold in Massachusetts increased 0.7 percent from May 2006 to May 2007. Condominium prices in Massachusetts remained above year-earlier levels, with appreciation of 1.4 percent in the median selling price from May 2006 to May 2007. Connecticut contacts also report increased overall prices, while the New Hampshire market features stable to declining prices versus year-before levels.

News of higher selling prices is tempered by lower transaction volumes and lengthening times on the market across the region. The volume of single family homes sold in Massachusetts decreased 7.5 percent from May 2006 to May 2007 while average days on the market increased from around 120 to nearly 140 days over this same period. Contacts in Rhode Island, Connecticut, and New Hampshire all cite declining year-on-year transaction volumes and some report specific locations and price segments with markedly reduced activity. Despite lower transaction volumes and increased days on the market, much lower total listings have led contacts to report that supply is returning to more normal levels. Supply in the Massachusetts single family market declined from 11 months' supply at current sales rates to 9.5 months between May 2006 and May 2007, as condominium supply fell from 10.4 months to 7.8 months.

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Second District--New York

The Second District's economy has continued to expand at a moderate pace since the last report, while price pressures have been stable. The labor market has remained steady and strong, and both manufacturing and other firms anticipate a modest increase in their employment levels, on balance, in the second half of the year. Tourism has shown signs of strengthening. Retailers indicate that sales were on or slightly below plan in June and early July, while selling prices have been steady to up modestly; consumer confidence in the region fell moderately in June and for the quarter overall.

Manufacturers report increasingly widespread growth in activity in June and early July, while they indicate that price pressures, though still fairly pronounced, have not intensified. Housing markets have been mixed since the last report, with New York City's market showing relative strength. Office markets in the New York City area showed signs of tightening. Finally, bankers report some slippage in loan demand--particularly on residential and commercial mortgages; they also note further tightening in credit standards, and a slight increase in delinquency rates on consumer and home mortgage loans.

Consumer Spending
Retailers report that sales were on or slightly below plan in June and early July, with same-store sales little changed from the same time last year. New York City continued to out-perform the rest of the region in terms of sales growth. Contacts note that sales of home goods remain sluggish, though one major retail chain reports that this area has picked up slightly in recent weeks. Apparel sales are reported to be fairly strong overall. Inventory levels are generally characterized as satisfactory, though one large chain describes them as a bit high. Retailers indicate that selling prices are steady to up modestly.

The Conference Board's survey of Middle Atlantic residents showed confidence retreating further in June, slipping to its lowest level in almost a year. Siena College's surveys of New York State residents indicate that confidence slipped throughout the state in the second quarter, with the steepest declines in the Albany and Binghamton areas. Tourism activity in New York City has been robust since the last report. Manhattan hotels remained at close to full capacity in May and June, while room rates and total revenues continued to run roughly 15 percent higher than a year ago. Broadway theaters report that both attendance and revenues picked up noticeably in June and early July, running close to 10 percent above year-ago levels.

Construction and Real Estate
Commercial real estate markets across the New York City area strengthened in the second quarter. Manhattan's office market tightened further in June, as asking rents continued to soar, rising more than 30 percent from mid-2006 levels. Midtown's vacancy rate edged up 0.1 point to 6.4 percent in June but is still down a full point from a year ago. Lower Manhattan's rate tumbled to 8.2 percent in June--down from 9.3 percent in May and 11.7 percent a year earlier--due partly to space removed from the market for residential conversions. Long Island's office vacancy rate was little changed at just above 10 percent in the second quarter, while the average (Class A) asking rent jumped 11 percent from a year earlier. Vacancy rates in Northern New Jersey and Fairfield County (CT) fell noticeably in the second quarter, reaching their lowest levels in at least five years, while Westchester's rate retreated to its lowest level since early 2006; asking rents in all three of these areas rose moderately.

Housing markets have been mixed but generally stable since the last report, with New York City continuing to show more strength than the rest of the region. Manhattan's co-op and condo market remained brisk in the second quarter: sales activity picked up further, with the number of transactions more than doubling from a year earlier, though prices have flattened out. The listing inventory is reported to have retreated fairly sharply from the exceptionally high levels of a year ago. A major regional rental management firm reports strong rental rate increases in southwestern Connecticut, and moderate gains in the Albany area, but flat rents across the Hudson Valley and the Buffalo area. Finally, New Jersey home-builders report ongoing weakness in new home prices; they also note that residential development activity has slowed further, particularly for age-restricted communities, and along the "Gold Coast"--communities along the Hudson River across from New York City.

Other Business Activity
The District's manufacturing sector has continued to show strength since the last report. Surveys of purchasing managers in both the Rochester and Buffalo areas indicate acceleration in business activity in June. More generally, New York State manufacturers report fairly widespread increases in business activity in both June and early July; contacts continue to express broad-based optimism about the six month outlook and plan to increase employment modestly, on average, in the second half of the year. Firms indicate continued fairly widespread increases in input prices but no more so than in recent months.

Similarly, non-manufacturing contacts in the district report continued moderate expansion in general business activity, increased optimism about the general business outlook, and prevalent planned increases in capital spending. Business contacts also indicate a recent pickup in hiring activity and, on average, expect to expand employment levels a bit more in the second half of the year than in the first half. Separately, a major New York City employment agency specializing in mid-level office jobs reports that the labor market has been steady and strong since the last report; hiring activity has continued at a brisk pace and companies continue to report difficulties filling jobs.

Financial Developments
Reports from small to medium-sized District banks suggest weakening demand for credit, tightening supply (standards), and a slight increase in household delinquencies. Bankers indicate a decrease in demand in all credit categories, particularly commercial mortgages, residential mortgages, and refinance mortgages. More bankers report tightening than easing standards, particularly on residential mortgages, for which roughly one in four indicate tightening. No bankers report eased standards in any loan category. Interest rates on all loans types and deposits were reported higher, on net, with the most widespread increases on residential mortgages. Overall, delinquencies are reported to be little changed since the last report, though some modest increases were reported on consumer and home mortgage loans.

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Third District--Philadelphia

Economic conditions improved in the Third District in June. On balance, manufacturers reported increases in new orders and particularly in shipments, although manufacturers of capital equipment saw reductions in both measures. Retailers experienced different conditions depending on the market segment they serve. Sales of high-end goods increased significantly, while sales of low-end merchandise remained flat or increased only marginally. Auto sales had increased over the past few months, while June saw significant declines with recovery expected in July. Overall bank lending rose only slightly, with residential and personal lending remaining flat and the commercial real estate sector seeing continued strong performance. Firms commenting on labor costs generally reported steadily increasing wages, but observations on nonwage benefits were mixed with some firms reporting acceleration and other reporting a slowdown in increases. Firms continued to report significant price increases for raw materials and energy.

Third District firms generally see business activity expanding in the second half of 2007, although bankers are less optimistic than in previous reports. Manufacturers plan higher levels of capital spending and expect more demand for their products in the months ahead. Retailers generally expect sales to increase at their current rate and the outlook from auto dealers has improved despite the slowdown in June.

Manufacturing
Third District manufacturers reported increases in shipments and new orders in July. The increase in shipments was by far the largest in the last six months, with four in ten manufacturers reporting increases and only two in ten reporting decreases. Order backlogs grew for the first time in over a year. Capital spending plans picked up somewhat over the past two months, with increases scheduled in most manufacturing industries. Firms involved in the production of lumber, petroleum, rubber and metal products reported increased activity in July while firms producing capital goods generally saw slower activity.

More than half the manufacturing firms contacted for this report expect an increase in new orders and shipments over the next six months, with only a few expecting decreases. Expectations for overall business activity are upbeat, with nearly half expecting increases.

Retail
Retailers in the Third District continue to report varying rates of growth depending on the segment of the market they serve, with overall sales quite strong in May followed by growth closer to trend in June. Sellers of luxury items continue to see growth in the double-digits on a year-over-year basis, while the growth rate for the upper-moderate segment remains robust. Moderate and low-end merchants experienced varying growth rates close to zero on average. Malls reported a continuation of the trend toward less traffic but higher average purchases. Some store executives reported decreases in inventories as anticipated, and they expect sales growth to continue at around the current rate.

Contacts report that, while remaining at relatively low levels, second quarter auto sales were significantly higher than in the first quarter. June brought decreases in sales, particularly for domestic nameplates, but dealers expect July numbers to show a recovery. They point to the arrival of new incentives for domestics as contributing to their improved outlook. However, dealers continue to close and consolidate at a high rate.

Finance
The volume of outstanding loans at Third District banks rose slightly in the second quarter and in June, according to lending officers interviewed in July. The picture is mixed, however, and members of the banking industry were generally less optimistic than they were at the time of the previous report. Though commercial and industrial lending, which remain the primary growth driver for banks, edged up, personal lending remained about flat.

Demand for residential mortgages also remained flat. Bankers noted that home equity borrowers almost exclusively sought fixed rate lines of credit, but that margins from the prevailing fixed rates are so low that there is little benefit to making the loans. Some bankers also reported that meeting lending targets for the year was no longer likely.

On a more positive note, other bankers reported that, in commercial real estate, the region is performing strongly, with delinquencies at low levels. Credit card lending also seems to remain a positive for the industry, with delinquencies and charge-offs still below historic trend levels. Investment companies reported continuing strong cash inflows to both equity and fixed income funds and other investment products.

In general, recent conditions do not seem to be as strong as they had been in the first quarter. It is, as yet, unclear whether or not this is the beginning of a trend or a temporary issue. Expectations were that downside risks for the industry are increasing rather than declining.

Services
Business services firms reported steady growth, with increased activity for existing client firms as well as work for new client firms, including significant increases in business from start-up and early-stage firms. Employment agencies and temporary help firms reported that demand for workers has been rising, and they expect the overall pace of hiring growth in the region to be around the same in the third quarter as it was in the second quarter. Service-sector firms generally expect business to continue to increase in the months ahead, and some anticipate a slight pickup in growth.

Prices and Wages
Business contacts noted recent increases in costs for some agricultural commodities. They expect a more general rise in prices for agricultural products in the future as demand grows for corn for ethanol and as the supply of other crops falls due to diversion of land to corn production. Firms continued to cite increased prices for raw materials and energy-related costs as a significant issue. Almost four in ten manufacturing firms reported increases in the prices paid for inputs and few reported any decreases, as in the previous report; in contrast, there was a rise in expectations for input cost increases over the next six months.

Most of the firms reporting on employment costs in July noted a continuing trend of moderate wage increases. Some noted that the rate of increase in wages and benefit costs appeared to be accelerating somewhat; however, others reported a slowdown in benefit cost increases.

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Fourth District--Cleveland

The economy in the Fourth District continued to grow at a modest pace during the past six weeks. In general, manufacturing output was stable to increasing with District auto plants reporting higher production during May. Activity in commercial construction is steady to improving with backlogs at acceptable levels. New home sales improved slightly, but sales remain down on a year-over-year basis. Most home builders said that inventories have returned to acceptable levels. Retail sales in the District were flat to increasing slightly. Commercial loan demand increased while consumer lending was stable to declining. The mortgage market continues to be slow. Oil and natural gas production showed little change. And the demand for trucking and shipping services was mixed.

On net, reports point to a slight increase in employment levels across the District with wage pressures limited to the energy sector and some highly technical and professional occupations. Accounts given by staffing firms reveal positive trends in job openings with an increase in the number of permanent openings. Our contacts also stated the number of job seekers was steady to increasing since late May and on a year-over-year basis. About half of our staffing representatives told us that wages are rising or they anticipate increases in the near future. A slight majority of manufacturers and builders said that input and energy prices are rising or remain at high levels.

Manufacturing
Most District manufacturers reported stable to increasing production levels during the past six weeks. On a year-over-year basis, a majority said they had increased their output. Top performers are found in the aerospace, power generation, machined products, food processing, and construction supply industries. Looking forward, almost all our contacts anticipate production remaining at current levels or increasing. Auto assembly plants reported higher production on a month-over-month and year-over-year basis. Domestic brands and their foreign counterparts shared in the increases. Although domestic makers expanded production at a higher rate, the total number of vehicles produced by foreign makers was larger. Shipments by steel producers and service centers varied widely. Contacts tell us they expect to maintain current shipment levels or experience some slowing in the 3rd quarter. Strong end markets for steel include aerospace, defense, non-residential construction, transportation, and appliances.

Plant utilization rates were at normal levels to 100 percent capacity. Almost all manufacturers reported that capital expenditures were on plan since late May with half of the respondents saying they expect to increase spending in the next 12 months due primarily to increased demand. Industries planning increased expenditures include aerospace, food processing, autos, petrochemicals, and construction supply. Manufacturers were evenly split when asked about the direction of input prices. The most often cited increases were for metals, fuel, and agricultural products. Only a few of our contacts increased their own prices and few anticipate raising prices in the near future. The manufacturing workforce rose slightly during the past six weeks. Hiring in the near future is expected to be very slow with little wage pressure reported.

Construction
We received a few reports that new home sales improved slightly over the past six weeks as builders entered the peak building season; however, sales remain down on a year-over-year basis. Looking forward, builders are uncertain when the housing market will turn around--speculation is in 12 to 24 months. Several builders experienced a decline in cancellations which they attributed to a tightening in credit standards. Most of our contacts said inventories have now returned to acceptable levels. In general, new home prices fell slightly since late May. Material costs are stable--rising copper prices being offset by a decline in lumber prices.

Most commercial contractors told us that business is steady to improving since late May; however, on a year-over-year basis, more than half reported that business has slowed slightly. Segments showing strong activity include healthcare, public works, and manufacturing. Nearly all respondents are satisfied with their current backlog. Contractors were mixed in their assessment of material costs with half stating that steel, concrete, and fuel increased; however, most held their own prices steady over the past six weeks.

Retail
District retailers reported flat to slightly increasing sales. The one bright spot was grocery stores where sales have been consistently strong since late May and on a year-over-year basis. Looking forward, retailers anticipate little change in sales trends. With the exception of food stocks and shipping, supplier prices held steady over the past six weeks. Hiring is limited to new store openings and little wage pressure was reported. Sales of new and used cars increased slightly on a month-over-month basis while SUV sales were sluggish except for luxury models. Showroom traffic has softened; however, customers who entered usually bought. Most dealers expect little variation in sales over the next few months.

Banking
Commercial loan demand generally increased since late May. Industries driving this growth were broad based. In contrast, consumer lending was flat to declining. Overall, auto loans held steady while home equity loans weakened. The mortgage market continues to be slow. Looking forward, several bankers told us they believe weakness in the mortgage market will continue throughout 2007 and into 2008. Core deposits were flat to slightly down. Almost all contacts reported little change in the number of delinquencies and credit quality for consumer and business applicants.

Energy
Oil and gas producers reported production levels were flat to increasing since late May and on a year-over-year basis. On balance, prices received for oil were flat to rising year-over-year while natural gas prices were flat to declining. Material and equipment costs were stable during the past six weeks but increased since last year. Limited hiring was reported with little workforce expansion anticipated in the near future. More than half our contacts said they have difficulty finding skilled field personnel. Almost all producers told us that wages are continuing to rise.

Plans for four coal liquification plants to be located in the Ohio Valley have been announced. Two of the plants would produce jet and diesel fuel while the other two would produce liquid coal for power generation. Estimated value of the four plants is $10 billion. Each would employ 200 to 300 full-time workers.

Transportation Demand for trucking and shipping services was mixed during the past six weeks with reports ranging from strong growth to softening. Industry representatives tell us that it is becoming very difficult to pass on non fuel-related price increases. However, about half reported that they were able to pass on rising fuel costs using surcharges. In general, capital expenditures have been flat to declining. Pre-buying engines in 2006 due to new EPA regulations was the most often cited reason for the decline. Wages have remained stable since late May.

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Fifth District--Richmond

Economic activity in the District generally advanced at a moderate pace during June and early July, with uneven growth across sectors. Following six months of declines, manufacturing rebounded behind increases in new orders and shipments. Additionally, the service sector continued to post strong revenue growth during recent weeks. Commercial leasing activity also maintained its solid pace, though pockets of softness in retail leasing were noted. In residential markets, contacts reported a slight improvement during the last six weeks as sales activity picked up a bit in some areas. Assessments of other sectors were not as rosy. The pace of commercial and mortgage lending activity subsided since our last report. Moreover, weakness in big-ticket categories continued to constrain overall retail sales, while a stretch of particularly hot and dry weather hindered crop development. Tourist activity was mixed. On the employment front, hiring activity across the District intensified since our last report, amid already taut labor markets. Turning to prices, contacts indicated that price growth in the District generally continued to rise as businesses passed along increases in raw material and finished good prices.

Retail
Reports on District retail activity were mixed in recent weeks. Contacts at department store chains and discount stores noted slightly stronger growth, though big-ticket sales continued to slump, especially in early July. An executive for a home-building supply chain told us that weak housing market conditions continued to damp sales and customer traffic at his stores. Softness in housing also affected furniture retailers as contacts reported slower sales during the period. In addition, automobile dealers noted that sales of domestic lines moved lower while foreign brands held up somewhat better. Amid the mixed sales reports, retailers complained that qualified workers were difficult to find. One contact said that wages for new hires had risen sharply, compressing his salary scale and driving other wages higher.

Services
Revenue growth at services-providing firms generally remained strong in June and early July. Contacts at healthcare and telecommunications firms, in particular, reported steady to greater demand during the period. Heating and cooling and electrical contractors also said business had increased. National freight-trucking businesses headquartered in the District told us that demand had firmed somewhat, but noted that their pricing power had eroded a bit. Overall, price growth at services firms generally moderated in recent weeks, while the pace of hiring picked up.

Manufacturing
District manufacturing activity bounced back in June and early July following six months of declines. Contacts reported strong increases in new orders and shipments, and noted that the recent weakness in employment had moderated somewhat. By industry, demand was notably stronger at fabricated metals, lumber, printing and publishing, rubber and plastics, transportation equipment, and textile firms. A contact at a machinery manufacturing firm in North Carolina told us that their business was on an upswing and a rubber producer in West Virginia said growing orders from European customers led him to boost production. On the price front, contacts noted that both raw material and finished good prices grew at a quicker pace since our last report.

Finance
The demand for mortgage loans tapered off in recent weeks. Contacts said the slowdown followed softer demand for higher-priced homes and residences in coastal markets. Recent interest rate increases were also cited as a cause for the softening. The pace of commercial lending in the District also moderated in recent weeks. Additionally, slight increases in delinquent loans were reported in both the commercial and mortgage sectors.

Real Estate
On balance, District residential real estate agents reported a small uptick in sales activity since the end of May. A contact in Greensboro, N.C., said that home sales had picked up in recent weeks with activity increasing across all price ranges. Sales were steady in the Greenville, S.C., area where strong job growth continued to fuel demand for housing. Likewise, an agent in Odenton, Md., reported solid home sales throughout June and early July. On the other hand, a Realtor in Richmond, Va., reported softer sales compared to a year ago and an agent in Asheville, N.C., told us that sales contracts in his area were becoming increasingly dependent on clients selling their existing homes. Reports on home prices were also less than rosy as prices moderated in some markets and fell slightly in others. On the commercial side, conditions were generally unchanged as leasing activity throughout the District remained strong. Contacts noted steady demand for office and industrial space, but expressed mild concerns regarding the performance of the retail segment. One Washington, D.C., contact reported a "surprising slowdown" in retail leasing activity. Additionally, agents in Richmond and in Washington, D.C., said there was significant downward pressure on rents of retail properties. In contrast, office rents rose in recent weeks with notable increases in the Washington, D.C., market. Little change was reported in commercial vacancies though a Richmond, Va., contact reported that the departure of a major company could add a large amount of office space to the market in coming months. Little to no new construction was reported since our last report.

Tourism
Tourist activity varied across the District since our last report. Contacts at mountain resorts in Virginia and in West Virginia reported stronger bookings for the week of the July 4th holiday compared to a year ago. A manager at a mountain resort in Virginia attributed the increase to exceptionally pleasant weather and families taking vacations closer to home. Tourist activity at coastal areas was mixed, however. A hotelier on the Outer Banks of North Carolina reported brisk restaurant sales and golf courses filled to capacity, while a contact in Virginia Beach, Va., noted a pullback in food and beverage sales. Moreover, a contact in Myrtle Beach, S.C., told us that vacationers seemed to be taking shorter vacations.

Temporary Employment
Temporary employment agents across the District reported stronger demand for workers since our last report. Hiring agents in both Raleigh, N.C., and Richmond, Va., said that increasingly taut labor markets in those areas continued to drive demand for temporary workers, particularly in life sciences and business services. Conversely, a contact in Hagerstown, Md., expected demand for temporary workers to wane during coming months due to softness in the local economy. Sales, administrative, accounting and warehouse skills were among those most highly sought during recent weeks.

Agriculture
A prolonged spell of hot, dry weather during June and early July depleted soils, delayed plantings, and stressed crops and pastures in many areas of the District. In Maryland and Virginia, a lack of soil moisture halted soybean planting and sapped corn crops. Additionally, a contact in Virginia noted that damage to pastures and hayfields was causing farmers to thin their herds and begin supplemental feeding of livestock. On a brighter note, apple and peach crops were reported to be in generally good condition in Maryland and West Virginia, and the small grain harvest was ahead of schedule in the Carolinas.

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Sixth District--Atlanta

Reports from District contacts painted a mixed picture of the District economy during June and early July. In the consumer sector, retail sales were uneven and vehicle sales were generally lackluster, whereas tourism activity was positive. Weak home sales and high inventory levels were leading to further reductions in construction. For the most part, the pace of nonresidential development remained positive. Manufacturing activity was generally stable, except for continued declines in sectors related to housing construction. Freight industry contacts reported weak demand from the housing construction and auto sectors. Labor markets remained tight, particularly for specialized occupations in healthcare and education, and in skilled trades. Price reports varied. Some building contacts reported lower timber costs, while others commented on rising fuel costs. Despite recent rains, the drought has severely limited the outlook of District crops and livestock.

Consumer Spending and Tourism
Most reports from District retail merchants noted that sales in June were uneven across stores, but on balance similar to a year earlier. Contacts also noted that sales were below plan. Additionally, most reported that inventories were flat to slightly up compared with a year ago. Retailers were cautiously optimistic going forward; most anticipate modest sales growth over the next several months.

District vehicle sales were mostly lackluster. Contacts reported that foreign brands outperformed domestic brands, and this was attributed to stronger demand for fuel-efficient models. However, some import distributors reported that the pace of vehicle sales in the District lagged behind other regions. Another contact noted that new vehicle registrations were much lower than last year, with Florida having the weakest performance.

Most reports indicated that tourism activity was holding up better than they had expected given high gasoline prices. Summer visitor numbers were described as good by contacts at north Florida hotels, and were stable in Miami and along the Alabama coast. With the Hard Rock Casino opening in July, and the recently completed addition to the Island View, the Mississippi Gulf Coast tourism market continues to recover. However, some New Orleans contacts noted that convention attendance has been lower than expected.

Real Estate
Most District homebuilders and Realtors reported that new and existing home sales continued to be below year-ago levels in June. Although construction continued to decline, inventories remained high across much of the District. Numerous reports pointed to declines in asking prices and increases in use of other incentives to try and stimulate sales. More positively, reports suggest that single-family home sales have stabilized in some Florida markets, and while weakness remained pronounced in Georgia, a few contacts noted a slight pickup in sales during June. Florida homebuilders anticipate flat sales over the next few months compared with a year ago, while the majority of Realtor contacts expect sales to decline further. Construction in most areas of the District is expected to remain well below the year-ago levels.

Reports from District commercial contractors indicated that the pace of non-residential development in the second quarter was flat to slightly down in Florida compared with a year ago, and increasing moderately elsewhere. Overall, most contractors outside Florida anticipate that activity will exceed year-ago levels for the remainder of the year.

Manufacturing and Transportation
Reports on manufacturing were mixed in June and early July. The lumber business remained sluggish, with producers in most states continuing to be adversely affected by weak demand for residential construction materials. Also reflecting the building slowdown, a concrete and cement maker experienced a 33 percent decline in sales. Apparel producers continued to cut payrolls, close facilities, and move operations offshore. More positively, contacts in the defense/aerospace industries see growth continuing. District shipbuilding activity is also expanding.

Several trucking companies that service building suppliers reported lower freight demand and less ability to pass on cost increases. Through mid-June, freight traffic at major regional railroads declined because of lower shipments of forest products and motor vehicles.

Banking and Finance
Commercial and industrial lending was described as strong in most parts of the District. Banking contacts continued to report reduced residential construction lending, and there were some reports of homebuilders facing financial distress. Higher foreclosure rates were reported in parts of the District, but overall, bank mortgage credit quality remained good. Deposit growth was described as stable.

Employment and Prices
Labor markets in most areas remained tight, and this was putting upward pressure on wages. Healthcare providers continued to struggle to fill vacancies, and education professionals were said to be in short supply. Contacts at accounting and information technology firms reported that positions were hard to fill. Also, some construction industry contacts noted ongoing shortages of skilled workers such as electricians and carpenters. Hotel and manufacturing

contacts said they are using overtime as well as staffing services to meet peak demand needs.

Residential and commercial builders noted less upward pressure on material inputs. Several contacts noted that competition for business was causing them to continue to absorb increases in the cost of labor, energy, as well as business and health insurance.

Agriculture and Natural Resources
Precipitation in early July did little to change the uncertain outlook for District farmers affected by severe drought conditions. Soil moisture shortages were very critical in most District areas. The lack of rains will significantly impact the corn and cotton crops in Alabama, and the peanut crop in Alabama, Florida, and Georgia. Pasture conditions were also poor, and some farmers liquidated their herds because of the lack of available grazing and hay. In Florida, tree destruction from past hurricanes as well as spreading diseases has resulted in a downward revision for this season's orange crop.

Deep water drilling activity remains high in the Gulf of Mexico, continuing to push up demand for rigs, equipment, and personnel. Refinery utilization rates in the Louisiana Gulf Coast area were maintained at high levels.

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Seventh District--Chicago

Economic activity in the Seventh District continued to expand at a modest pace in June and early July. Consumer spending and business outlays rose at rates similar to those reported earlier in the year. Labor market conditions were mixed by industry and location. Residential construction declined further in most areas, while the pace of nonresidential development was generally steady. Conditions in manufacturing were little changed from the past reporting period. Household lending declined, while business lending edged up. Energy costs rose, and on balance, other prices increased at a steady rate. Wage gains were similar to those in the previous reporting period. Growing conditions for corn and soybeans deteriorated in most of the District due to hot and dry weather.

Consumer Spending
Consumer spending continued to increase at a gradual rate. Retailers said that sales gains in June and early July were moderate, though a few national chains reported that sales in the Midwest were stronger than other regions. One industry analyst said that consumers were being more cautious due to persistently high gas prices and rising food prices. Inventories were generally in line with desired levels, though some retailers said they were being more conservative than usual to avoid end-of-season discounts. Vehicle sales in the District during early July were running a little better than the June pace according to one auto dealer. Vehicle inventories were a bit below seasonal norms. A restaurant chain reported strong sales and that results for the quick-casual segment continued to be better than for sit-down restaurants. Tourism activity varied throughout Michigan. One contact said that activity was "down significantly from last year," while a hotel in another location reported a 15 percent increase in occupancy; most contacts, though, projected that tourism in their areas would stay in line with recent experience.

Business Spending
Business spending rose again in the District. Capital expenditures continued to increase in line with previous plans for modest gains. Truck freight loadings declined modestly on balance, though shipments of bulk commodities were strong. A regional airline reported an increase in bookings and load factors during June. Changes in labor market conditions were mixed by industry and location. Several toolmakers reported expanding payrolls; a pharmaceutical company said the number of new hires and job openings were both strong; and a distribution center reported an increase in its head count. In contrast, a nationwide homebuilder announced it was exiting the Indianapolis market; a construction materials firm cut jobs after deciding not to rebuild a plant destroyed by a fire; and a bank said it laid off more workers than it initially planned. Billable hours for temporary placements were declining at a steady rate, but one staffing agency expected some firming in the second half of the year.

Construction/real estate
Residential construction and home sales fell again in most areas. Home builders reported steeper declines in construction in Des Moines and central Indiana, and a contact in Milwaukee said many area builders had trimmed their holdings down to only model homes. A builder in southeast Michigan projected further declines in the coming months. Realtors in most markets noted that homes were taking longer to sell, though a contact in the Detroit area said selling times edged down from high levels, and a banker in Iowa reported that rural residences were still selling quickly. Home prices were increasing at slower rates, and one contact said some sellers were even offering cars and plane tickets as added incentives. Contacts in Indiana and Wisconsin said an unusual number of sales were distressed properties (fixer-uppers or foreclosed homes). Still, analysts in Indianapolis and Des Moines characterized sales conditions as returning to "normal" or "traditional." The pace of nonresidential development was generally steady. A developer from Indiana said that industrial construction increased slightly. Nonresidential vacancies were steady or improving in most areas.

Manufacturing
Conditions in manufacturing were little changed compared with the previous reporting period. Manufacturers of machine tools and equipment parts continue to report the best results; contacts in these industries said sales to defense, electronics, and medical customers were strongest. Demand for some agriculture machinery was higher than expected and forecast to strengthen further in the second half of the year due to high commodity prices. In contrast, sales to domestic customers of other heavy equipment, particularly construction machinery, were flat between May and June and below expectations. However, manufacturers in a number of industries, including machinery and heavy trucks, reported strong demand from abroad. New heavy truck orders in the US remained weak, and although contacts believed sales would bottom out the second quarter, they were not expecting much of a recovery until 2008 or 2009. An automaker said that nationwide sales in early July seemed "a little soft." Vehicle inventories were "coming into normal levels," though stocks of fuel-efficient models were low. A steelmaker said the market was flat at "not bad, but not robust" levels. Steel inventories continued to move lower, and one contact thought that an inventory build would be needed by the end of the summer. Contacts said that shipments of cement continued to fall due to the weakness in housing.

Banking/finance
Household lending declined modestly. Consumer credit quality deteriorated slightly; delinquency rates for home equity loans and lines of credit edged higher, though delinquencies for first mortgages were little changed. Foreclosures increased in Michigan and Wisconsin. Lenders were tightening mortgage borrowing requirements, but one banker noted that underwriting capacity remained greater than loan demand and mortgage spreads were "as thin as I can remember." Business lending was flat in Michigan and growing weakly in other areas. Business credit quality remained favorable, though one banker in the Detroit area described it as "slightly less pristine." A bank in West Michigan reported that a significant portion of its nonperforming loans were to a single homebuilder. Standards and terms of commercial loans were competitive though tightening modestly, according to one contact.

Prices/costs
Outside of energy, nonwage price pressures and overall wage increases were similar to those in the previous reporting period. Almost every contact noted higher gasoline prices, which were attributed in part to a soon-to-be-resolved disruption at an Indiana refinery. A trucking firm said it had been able to recover much of the fuel cost increase through surcharges. Several other commodity prices, such as scrap steel, coke, and copper, remained at high levels. A contact in the cement industry reported some potential for price increases with fewer imports coming into the U.S. Vehicle incentives were generally steady, well below year-earlier levels, and one automaker said it had no plans for any new discounts. Average airfares declined at one carrier, and hotel rates in Michigan were generally steady. A staffing firm reported that its pay rates rose at a steady pace.

Agriculture
The condition of the corn and soybean crops deteriorated in much of the District during the reporting period. Crop conditions were worse than the previous year in Indiana and Michigan, reflecting hot and dry weather. Recent data indicate that more corn was planted than reported earlier, and corn prices moved sideways from early June to mid-July. Soybean prices moved higher. Forage and pastures were hurt by the lack of precipitation, leading to higher prices for hay. Higher feed costs squeezed livestock and dairy producers. Even so, increased dairy prices allowed dairy operations to make a profit, and while hog prices were down by the end of the reporting period, they remained high enough for producers to earn profits. Cattle prices also fell, and cattle operations struggled to avoid losses.

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Eighth District--St. Louis

Economic activity in the Eighth District has expanded moderately since our previous survey. Reports from manufacturing were generally positive, and reports from the services sector indicated continued expansion. Market conditions in both residential and commercial real estate, however, were mixed. Total lending activity at a sample of small and mid-sized District banks increased from late March to mid-June.

Manufacturing and Other Business Activity
Overall, manufacturing activity appears to have increased slightly since our previous survey. Firms in both the aerospace and motor vehicle parts manufacturing industries reported plans to build facilities, expand production, and hire additional workers. A contact in oil and gas field machinery manufacturing reported plans to build new facilities in the District and a contact in paper manufacturing reported plans to hire additional workers. Firms in the bio-fuel manufacturing and motor vehicle manufacturing industries reported plans to hire additional workers. In contrast, firms in plastic product manufacturing reported decreased operations and plans to lay off workers. A contact in the household appliance manufacturing industry reported decreased production compared with last year. Firms in wood product manufacturing reported cash flow problems.

The District's services sector continued to expand. Contacts in the business support services, health services, and professional, scientific, and technical services industries announced plans to expand facilities and hire additional workers. Retail sales have increased at a moderate pace despite high gas prices. Auto sales were higher in June and the first half of July compared with the same period last year. Auto dealers indicated that demand for hybrids, small sedans, and smaller sport utility vehicles has been high, but large vehicles and sport utility vehicles have not been selling well.

Real Estate and Construction
Home sales continued to vary substantially across the Eighth District. Compared with the same period in 2006, May 2007 year-to-date home sales were up 3 percent in Louisville and unchanged in Little Rock. Year-to-date home sales declined 10 percent in Memphis and 4.5 percent in St. Louis. Residential construction continued to decline throughout most of the District. May 2007 year-to-date single-family housing permits fell in nearly all metro areas compared with the same period in 2006. Permits declined 25 percent in Memphis and 12 percent in St. Louis and Little Rock. Permits, however, increased 15 percent in Louisville.

Commercial real estate market conditions were mixed throughout the District. The first-quarter 2007 office vacancy rate decreased in St. Louis over the fourth quarter of 2006. During the same period, the industrial vacancy rate in St. Louis increased slightly. In Memphis, contacts reported that industrial leasing activity is up after a slow start in the first quarter. Contacts in Jackson, Tennessee, reported that commercial construction activity remains strong. Contacts in Little Rock reported plans to build a new industrial plant.

Banking and Finance
Total loans outstanding at a sample of small and mid-sized District banks increased 1.7 percent from late March to mid-June. Real estate lending, which accounts for 74.7 percent of total loans, increased 1.5 percent. Commercial and industrial loans, accounting for 16.7 percent of total loans, increased 0.3 percent. Loans to individuals, accounting for 4.6 percent of total loans, increased 4.4 percent. All other loans, roughly 3.9 percent of total loans, rose 8.3 percent. During this period, total deposits at these banks increased 0.1 percent.

Agriculture and Natural Resources
Development of the major District crops was reported to be at or ahead of their 5-year average pace, except for soybeans in Missouri. As of mid-July, at least 89 percent of the District states' total corn, soybeans, cotton, sorghum, and rice crops were rated in fair or better condition. The winter wheat harvest was reported to be at least 95 percent complete in all District states except Indiana and Missouri, where at least 80 percent of the harvest was complete. Because of excessively dry weather, pasture conditions have deteriorated in Indiana, Kentucky, and Tennessee since our previous report, while conditions in the rest of the District states have improved.

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Ninth District--Minneapolis

The Ninth District economy grew moderately since the last report. Growth was noted in consumer spending, tourism, services, commercial construction real estate, manufacturing, energy and agriculture. Residential construction and real estate activity decreased and mining was flat. Labor market conditions tightened, and overall wage increases were moderate. Price changes were generally modest, except for significant increases in gasoline and copper and decreases in lumber.

Consumer spending and Tourism
Consumer spending increased moderately. A North Dakota mall manager noted that recent sales were up about 5 percent. Retailers in northeastern North Dakota noted an increase in the number of Canadian shoppers. Traffic at a Montana mall was up about 2 percent, and sales were up about 8 percent in June compared with a year earlier, according to the manager. A major Minneapolis-based retailer reported same-store sales up about 3 percent in June compared with a year ago. An auto dealership in Montana reported strong sales, especially for import lines, but slower sales for domestic vehicles; sales continue to tilt toward more fuel-efficient vehicles.

Tourism activity was up from a year ago. A number of resort and motel owners in the Upper Peninsula of Michigan noted that reservations in June and early July were as good or slightly better than a year ago. Tourism activity on the weekends before and after July 4th were busy in northwestern Wisconsin, according to a chamber of commerce representative. Another chamber of commerce representative noted that tourism activity was going well in northeastern Minnesota after a slow spring. Tourism businesses in Montana were reporting a strong summer, according to an official; many more Canadians were vacationing in northwestern Montana than a year ago.

Services
The professional business services sector saw growth compared with last year. Results of an ad hoc Minneapolis Fed July survey of professional services companies indicated that business activity increased from a year ago and is expected to increase over the next year. Accountant and consultant contacts reported increased billings and plan to expand their businesses over the next year. Appraisers, researchers and other business-support firms reported slight growth in activity from a year ago and expect this trend to continue. Business activity was mixed, according to contacts from legal and executive search firms.

Construction and Real Estate
Construction activity was mixed with commercial up slightly and residential down. Commercial construction contacts in central Minnesota and Montana saw slowing growth. However, a materials supplier in Minneapolis-St. Paul noted a number of large commercial projects under way. Construction began on a 240,000 square foot energy-efficient office building in suburban Minneapolis. Several contacts noted wastewater treatment facilities under construction around the District. However, residential construction decreased, as June building in Minneapolis-St. Paul slowed from a year earlier. Multifamily construction appears steady in many areas, including increases over the past year in Sioux Falls, S.D., and Rochester, Minn.

Real estate activity was also mixed with commercial real estate up and residential down. An analyst noted that large investors have purchased a number of big-ticket office buildings in the Minneapolis and St. Paul central business districts. Office vacancy continued to decline in Minneapolis-St. Paul; however, the industrial sector saw negative absorption in the second quarter. Residential real estate was slower than a year ago. June home sales were down 16 percent in Minneapolis-St. Paul; sales in Fargo, N.D., were down slightly. In contrast, a Realtor in Grand Forks, N.D., described the market as growing steadily, and home sales are on track to beat last year's record level.

Manufacturing
Activity in the manufacturing sector grew since the last report. A June survey of purchasing managers by Creighton University (Omaha, Neb.) indicated increased manufacturing activity in Minnesota and the Dakotas. In Minnesota, a metal fabricator reported that business was "booming," primarily due to increased exports. In South Dakota, a mining equipment manufacturer reported strong demand and a food processor plans to add a new facility. A North Dakota company that installs heating equipment noted that interest in industrial systems was increasing.

Energy and Mining
Activity in the energy sector increased since the last report, and mining was flat at high levels. Alternative energy projects continued at a strong pace. Oil and gas exploration and production in the District was level from previously reported amounts. Production at most mines remained at near capacity across the District. However, production at a Montana mine was reduced due to a recent worker strike.

Agriculture
Agricultural conditions improved since the last report. The U.S. Department of Agriculture reported that crop progress was ahead of last year and the five-year average for many District crops. A Montana bank director noted excellent agricultural conditions, with robust yields expected and prices up significantly from a year ago. However, the director noted some softening in corn prices since the last report.

Employment, Wages and Prices
Labor markets tightened modestly since the last report. In Minnesota, an aviation company recently announced plans to add 150 jobs and a molding company is expected to add 250 new jobs over the next three years. A business software company plans to add 80 jobs in northwestern North Dakota, and a new finance operations center will provide up to 150 jobs in Montana. Labor markets continue to be very tight in northeastern Montana; a bank director noted that a large number of businesses have posted "help wanted" signs. A temporary staffing agency survey of Minneapolis-St. Paul businesses showed that 44 percent of respondents expect to hire workers during the third quarter, while 11 percent expect to reduce staff. These results indicated stronger employment growth from a year ago, when 33 percent expected increased hiring and 13 percent anticipated decreases.

However, Minnesota unemployment insurance claims in June were about 12 percent higher than a year ago. In addition, a disk drive parts maker recently announced plans to cut 245 jobs in Minnesota, 165 in northwestern Wisconsin and 90 in South Dakota.

Overall wage increases were moderate. For example, an association of state employees in Minnesota recently reached a tentative contract agreement that calls for wage increases of 3.25 percent annually over the next two years.

Price changes were generally modest, except for significant increases in gasoline and copper and decreases in lumber. According to the respondents to a recent St. Cloud (Minn.) Area Business Outlook Survey, 35 percent expect prices received for their company's products to increase over the next six months, down from 39 percent in last year's survey. Gasoline prices in Minnesota climbed over $3 per gallon during early July, about 25 cents higher than a month earlier. Copper prices also increased in early July. However, softwood lumber prices were down more than 10 percent compared with a year ago.

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Tenth District--Kansas City

The Tenth District economy continued to grow in June and early July, but at a moderating pace. Consumer spending was mixed, with reportedly level retail sales but robust activity in the travel and leisure industries. Manufacturing activity slowed and residential real estate activity remained weak, but these trends were partially offset by strong commercial construction activity. Energy activity continued to rise. Recent precipitation improved growing conditions, although excess moisture in some areas limited wheat production. Overall, District labor markets continued to expand, with announced hiring outpacing planned layoffs. Reports of labor shortages and wage pressures remained unchanged from the last survey period. Price pressures generally eased modestly despite high agricultural and energy prices.

Consumer Spending
Consumer spending varied across sectors in June and early July, but sentiments about future activity were positive. Most retailers reported no change in sales from May, which were below expectations reported in the last survey. Sales of lumber, apparel and electronics were stronger, while home furnishings sales were weak. Nonetheless, store inventories decreased and retailers anticipated faster sales growth in the months ahead. Auto dealers reported sales were somewhat below expectations and lower than one year ago, but they remained optimistic about future sales. Travel and tourism spending was robust during the survey period, with District contacts optimistic about future activity. Restaurants reported stronger sales growth than in May. Hotel occupancy rates and average room rates rose solidly.

Manufacturing Manufacturing activity slowed in June, although expectations about future activity improved. The slowdown was concentrated in food processing, machinery manufacturing, and transportation equipment manufacturing. The backlog of orders increased, as a reduction in both employment and work hours accompanied the drop in output. Inventories of materials and finished goods increased again, after edging up in May. Despite the immediate reduction in manufacturing activity, plant managers remained optimistic. Production, shipments and new orders were expected to return to levels comparable to May. Although District manufacturers trimmed their capital expenditures slightly, they expected capital spending to resume at prior levels in the coming months.

Real Estate and Construction
The residential real estate sector remained weak in most areas, while commercial real estate activity continued to expand. District residential sales slowed from May and were below year-ago levels. Nevertheless, there were positive reports about residential real estate activity in parts of New Mexico and Wyoming. Several sources from throughout the District reported that low to mid-priced homes sold better, while the market for condominiums and upper-end homes remained weak. Home sales prices continued to decline in most markets in June and early July, but at a slower pace than in May. Home inventories remained up from the same time last year. Commercial real estate activity expanded moderately in June and early July. Office vacancy rates continued to trend down and were expected to decline in future months. Absorption rates remained unchanged from the May survey but were expected to increase further in future months. Growth in commercial rents moderated from the May survey, but expectations point to future increases in rents.

Banking
Bankers reported that loan demand edged down and deposits were unchanged since the last survey. Demand for residential mortgage loans declined slightly, while demand in all other categories remained basically unchanged. On the deposit side, a few bankers noted a shift in funds from demand deposits to interest-bearing accounts. Lending rates and lending standards were unchanged.

Energy
Energy activity rose in June and early July, with the total number of drilling rigs increasing in all major energy-producing states in the District. Energy activity was expected to increase further due to the recent jump in energy prices. Labor constraints in the District energy industry eased slightly, with fewer contacts reporting difficulty finding qualified workers and more companies intending to add staff.

Agriculture
Agricultural conditions were generally favorable, though wet weather raised concerns about the District's winter wheat crop in some areas. Heavy rains in Kansas and Oklahoma, which caused some flooding, delayed the winter wheat harvest and led to deteriorating crop conditions. Other parts of the District, however, reported above-average wheat yields. Recent precipitation also further eased drought conditions and improved pasture conditions. Despite some late planting due to wet fields, both corn and soybean crops were reported to be growing well. The hog market remained solid, while a recent dip in cattle prices tightened margins for cattle producers. High crop prices continued to bolster farm financial conditions, and loan repayment rates remained high and the number of requests for loan renewals and extensions eased further.

Labor Markets and Wages
District labor markets continued to add jobs in June and early July, albeit at a slower pace than in the previous survey period. Hiring announcements continued to outpace planned layoffs, but net hirings were lower than in previous months. Several aircraft manufacturers announced hirings, while some District financial services and healthcare companies trimmed staff levels. District contacts continued to report labor shortages. Many of these reports were in skilled occupations, like finance and engineering, but not exclusively; District contacts also reported a shortage of sales professionals. Contacts in the retail, leisure and hospitality industries reported difficulty finding and retaining workers across all levels of staff, including management. The same proportion of respondents reported wage pressure as in the previous survey.

Prices
Price pressures eased in June and early July, despite high energy and agricultural prices. District manufacturers reported lower raw materials prices in June, while manufacturing selling prices remained relatively unchanged from May. The vast majority of retailers reported either flat or lower retail selling prices. Most retailers expected similar patterns going forward, with the exception of lumber retailers, who expected higher prices. Restaurants anticipated raising menu prices in future months in response to higher food costs.

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Eleventh District--Dallas

The pace of economic activity in the Eleventh District was moderately strong but decelerated slightly in June and early July. Unusually wet weather dampened activity in several sectors. Most contacts remain cautiously optimistic that overall economic growth, while slower than a year ago, will not deteriorate further. Manufacturing activity cooled, but there was a slight rebound in the service sector. Energy activity remained high but with little growth. Residential construction and real estate continued to soften, but nonresidential activity is still robust. There was little change in the financial services sector. Agricultural conditions continue to be mostly favorable.

Prices
Input cost pressures are straining most industries, and competition is making it difficult to pass these higher costs to selling prices in many instances. Energy costs remain high, and many companies say that freight, rail and trucking rates continued to escalate. Increased demand for corn to produce ethanol has resulted in higher prices for all types of food, including meat, flour, shortening and dairy products.

International tensions pushed up crude oil prices to the highest level in 10 months. While strong, demand was restrained by low rates of refinery utilization that caused crude inventories to swell above 5-year averages. Wholesale gasoline prices fell after the Memorial Day holiday, but picked up with rising crude prices and the July 4 holiday. Gasoline inventories are well under five-year averages. Weak demand and high inventories pushed down prices for natural gas to near $6.50 per million Btu in early July. Natural gas inventories are 18-20 percent above the 5-year average. Prices increased for some petrochemicals.

Overall home prices have held steady, but incentives on new homes are prevalent and contacts expect a price correction for entry level homes. There is also downward pressure on prices for many materials used in home construction. Office rents continue to rise, but contacts expect rental increases to ease as new supply keeps vacancies steady. Prices are up for some products used in nonresidential construction. Producers of ready mix report that they had no problems raising prices, but cement manufacturers say they may need to back down from a recent price increase.

Labor Market
The labor market remains tight. Most firms report wage increases between 3 and 4 percent, but wage pressure is stronger in Houston and for workers with skills in high demand. For example, there continues to be a shortage of accountants, and salaries are expected to increase between 5-8 percent this year. Some manufacturers have reduced production and employment but others are hesitant to let go of skilled workers. Homebuilders continue to lay off workers, but the labor market remains very tight for commercial construction.

Manufacturing
Softer demand for construction-related products caused many producers to revise down their outlook for the year. Sales to homebuilders continued to slow, and some commercial projects have been delayed because high construction costs have caused budgetary concerns. Extremely wet weather has disrupted building in the District, but contacts note that construction activity continues to be better here than in the nation. Inventory levels have increased for most products, and production has been cut back. Manufacturers of stone, clay and glass reported sales down 5 to 12 percent over the past six weeks. Fabricated metals producers say activity has been flat, but sales of primary metals have softened substantially for some firms. Lumber producers report demand is flat or up but say sales are below a year ago.

Sales of corrugated boxes have been stable, with high demand to supply the maquiladora industry along the Mexican border. Overall activity is below a year ago, which paper producers attribute to manufacturing production moving out of the United States. Food production has been in line with the typical seasonal pattern.

Demand for transportation manufacturing continued to be strong, particularly to supply the chemicals and defense sectors. Contacts are optimistic about sales growth, although they expect a precipitous drop in defense-related work in 6-12 months. Sales of high-tech products were up slightly. Demand for new semiconductor machinery and equipment has begun to soften, however. This is partly the result of changes in production technologies, but contacts also noted reduction of semiconductor capacity in the District. Inventories are mostly at desired levels.

Although rising, refinery utilization remains below normal; held down by high levels of planned maintenance, a large number of unplanned outages, and continuing shortages of labor and skills to deal with the maintenance problems. Refiner profits remained high. International demand for petrochemicals continues to be strong, and domestic demand is slowly improving.

Services
Demand for business services was very similar to the last report, but transportation activity picked up. There continues to be strong demand for accounting services, with brisk demand directly and indirectly from the energy industry. Temporary staffing firms say demand was unchanged, with continued strong orders for workers with accounting, financial and IT skills. Orders were mostly to fill existing positions, with few new positions being added. Demand for legal services was also unchanged--at or slightly above the level of a year ago. Transactional and corporate real estate activity was still very strong, but bankruptcy and litigation work remained slower than a year ago.

Trucking activity improved but remained slightly under last year. Rail cargo volume is very high but weakened slightly, which railroads attribute to weather disruptions. Rail shipments of grain and construction materials declined, but volumes increased for petroleum products, chemicals and metallic ores. Small parcel shipping firms said cargo volume continued to be good, and noted the outlook improved. Container trade activity decreased slightly but remained well above a year ago.

Demand for air travel has been strong, and airplanes are flying fuller than ever. Contacts say traffic was stimulated by low fares. Airlines are now raising fares and, so far, there is no sign that bookings are dropping off. An unusual pattern of storms caused higher than normal cancellations and longer than usual delays because full flights left less flexibility to manage displaced passengers. Contacts in other industries have complained that flight delays have reduced productivity.

Retail Sales
Most retailers reported weaker than expected sales. Consumer spending continues to be affected by high gasoline costs, according to contacts who say that customers are seeking value. Abnormally wet weather also affected sales in recent weeks. Still, firms selling to the national market report better sales in the Eleventh District than in most other parts of the country. Auto dealers say flat demand and plentiful inventory led to an increase in discounts and incentives.

Construction and Real Estate
Real estate contacts have revised down their outlook for both homes and apartments. Homes sales are below a year ago, and starts have slowed sharply. Rain may have affected sales, but contacts attribute the weakness mostly to tighter lending standards for lower income borrowers, less investor activity and a wait-and-see attitude among homebuyers. Most of the downturn has been for lower priced homes, but Dallas contacts report higher-priced markets also being affected. New home inventories dipped slightly but remain high. Apartment demand has been weaker than expected, except in Austin where demand and rents continued to rise. In some Dallas/Fort Worth suburbs, houses rent for less than apartments.

Office demand picked up from the lackluster pace recorded earlier this year. Absorption is below last year, but contacts say leasing demand is healthy. Office construction is robust in Dallas and continues to pick up in Houston and Austin. Out-of-state investors are boosting demand for industrial space, but new construction is keeping vacancies relatively unchanged.

Financial Services
Consumer lending remained somewhat softer than earlier this year. Contacts still report solid growth in commercial lending, and pricing on loans is very competitive. Banks and credit unions report no deterioration in credit quality. Deposits are still difficult to obtain.

Energy
Domestic drilling remained at high levels, but there was little growth. With 85 percent of domestic activity geared to natural gas, bearish inventories and lackluster pricing provide limited incentives to expand drilling. Many rigs have been moved from the Gulf of Mexico to earn better rates and avoid the hurricane season. The supply of rigs, drill pipe and equipment has caught up with domestic demand, slowing new orders and easing price pressure. New orders and margins are much better for international work, which has remained strong despite slowing in Canada.

Agriculture
Widespread rain and cooler than normal temperatures improved livestock conditions and boosted range and pasture growth. Most crops are off to a good start and yields look promising, especially for wheat, corn and grain sorghum. Rain slowed cotton development in West Texas and delayed wheat and hay harvesting. Increased demand for ethanol has shifted relative crop prices and changed production from last year. Planted acreage for corn is up 19 percent, grain sorghum is up 45 percent and cotton is down 22 percent.

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Twelfth District--San Francisco

The Twelfth District economy expanded at a moderate pace during the survey period of early June through mid-July. Overall price inflation was modest; labor compensation rose moderately overall, although upward pressure remained strong for selected worker groups with specialized skills. Reports on retail sales were mixed, while service providers saw further sales gains but at a reduced pace in some cases. Manufacturers' reports pointed to expansion on net, and agricultural producers saw solid demand growth. Housing market activity was weak overall and slowed further in many areas, while demand for commercial real estate continued to firm. Banks reported growth in loan demand with the exception of residential mortgages.

Wages and Prices
Reports from District contacts indicated that price inflation was modest overall. Increases in the costs of energy and selected commodities and raw materials created significant upward price pressures in some sectors, especially for food producers and providers of transportation services. By contrast, upward price pressures eased for products that use stainless steel, due to a sharp drop in the price of nickel, one of its key components. Also, ongoing price declines for products in very competitive markets, notably apparel, electronic goods, and computer services, helped to hold down overall inflationary pressures.

Growth in labor compensation continued at a moderate pace overall. The reports in general were mixed, with some contacts in areas with especially tight labor markets pointing to a recent pickup in wage growth and some contacts in other areas pointing to moderation. Wages continued to grow at a brisk clip for selected worker groups with specialized skills, such as engineers and some occupations in the financial services sector.

Retail Trade and Services
Reports on retail sales were mixed. Department stores and major retail chains reported moderate sales gains relative to a year earlier, although inventories have risen of late. Demand remained sluggish for furniture and products used for home improvement, with widespread sales declines noted, while high prices for retail gasoline reportedly reduced consumers' purchasing power and limited spending a bit more generally. High gas prices also reportedly held back new vehicle sales, which were little changed from the previous survey period. By contrast, sales of used vehicles were strong and their sale prices firmed, partly as a response to a reduced supply of used cars from car rental agencies.

Sales by service providers continued to expand on net, but the pace moderated in some cases. Growth remained especially rapid for providers of health-care services, and it picked up for some providers of computer services, but it slowed for some categories of professional services. Travel and tourism activity was at a high level overall, although reports from various areas suggested weakness in foreign tourist activity despite relative strength in foreign currencies. Tourist activity in Hawaii picked up somewhat of late, but growth in domestic tourist visits and spending have been largely offset by the reduced number of visitors from Japan this year.

Manufacturing
Demand for District manufactured products expanded on net during the survey period of early June through mid-July. Increases in already large order backlogs kept producers of commercial aircraft and their suppliers operating at or near full capacity, and demand picked up a bit for products related to national defense. Apparel and food manufacturers reported solid sales gains, while makers of industrial equipment continued to report "steady" conditions. Contacts noted that sales of exported items generally grew at a more rapid pace than earlier this year, due in part to a reduction in export prices arising from the lower foreign exchange value of the U.S. dollar. By contrast, sales fell further for makers of building materials, household appliances, and furniture. Conditions were largely stable for makers of information technology products; semiconductor sales were up slightly in unit terms compared with the same period last year, but capacity utilization remained a few points below its level from early 2007.

Agriculture and Resource-related Industries
Demand for agricultural products continued to grow and supply conditions were largely favorable. Contacts reported robust sales growth and higher prices for most commodity and specialty crops, notably corn used in ethanol production, compared with the same period a year ago. Contacts also noted that export sales have grown substantially of late, as overseas buyers have responded to favorable exchange rates. Input supply generally was stable, although refrigerated shipping capacity has dropped and prices have risen substantially.

Real Estate and Construction
Activity in District housing markets slowed further on net, while demand for commercial real estate rose. In most areas, average time on the market rose and sales of new and existing homes remained low or fell. The slowdown has expanded to encompass areas where housing markets had remained hot into early 2007, such as parts of Utah and Idaho; however, prices continued to rise in areas where local economic conditions remain strong, such as those states plus Hawaii and the Seattle area. On the commercial side, vacancy rates for office and industrial space edged down and rental rates rose further in most District cities. Construction activity for commercial and public projects expanded in some areas, partly offsetting declines in residential construction activity and keeping the supply of construction labor and materials somewhat tight.

Financial Institutions
District banking contacts reported that loan demand grew further, with the exception of residential mortgages. Declining demand for residential mortgages was offset by growing demand for commercial lending, including commercial real estate loans. Although credit quality was at favorable levels overall, it continued to deteriorate for home mortgages, primarily for subprime mortgages in areas where house values have dropped over the past year. In response, mortgage lenders have tightened underwriting standards.

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