June 14, 2006

Summary of Commentary on Current Economic Conditions by Federal Reserve District

Summary

Prepared at the Federal Reserve Bank of Dallas and based on information collected on or before June 5, 2006. 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 all twelve Federal Reserve Districts indicate that economic activity continued to expand from mid-April to early June, but there were some signs of deceleration. Activity moderated in four Districts--Atlanta, Kansas City, Richmond, and San Francisco--and the New York District noted increased concern about the outlook for the second half. Seven Districts--Boston, Chicago, Cleveland, Dallas, Minneapolis, New York, and St. Louis--said growth was similar to the pace reported in the last Beige Book. The Philadelphia District, however, reported an improvement in overall economic conditions.

Consumer spending continued to increase, but District reports suggest that the growth rate slowed. Manufacturing activity still expanded quite strongly, but reports indicate more areas of weakness than in March and early April. Residential real estate markets continued to cool across the country, with slower homebuilding and sales of existing homes. In contrast, commercial real estate activity strengthened, and a few reports expressed concern about too much building in some portions of the real estate market. Activity in service-producing industries was strong or increased in all Districts that reported on that sector. The financial sector continues to report good credit quality. Commercial lending picked up, but there was some slowing in loans to consumers, particularly for mortgages and home equity loans. Growth in the energy industry continued to be robust, with expansion constrained by shortages of equipment and labor. Agricultural conditions varied across the country.

Labor markets continued to tighten, with more Districts reporting employers having difficulty finding skilled workers. Wage pressures remained moderate overall, with the exception being workers with hotly demanded skills. High energy costs were fueling price increases in manufacturing and, to a much lesser extent, retail. Reports of costs being passed forward varied considerably but were more prevalent than in the last Beige Book.

Consumer Spending

Consumer spending continued to increase between mid-April and early June, but reports were varied, and several Districts noted areas of weakness. Some Districts mentioned that sales were slowing or weaker than anticipated at discount stores or to lower income customers. High gasoline prices were cited by a few Districts as changing purchasing patterns or clouding the outlook for sales. A couple of Districts also said that rising interest rates were a concern. Inventories were mostly reported to be at desirable levels, but the Atlanta, Boston, and Kansas City Districts said some retailers had more inventory than they would like.

Two Districts reported weaker retail sales growth--Dallas and Richmond--and retail sales were "down" compared with last year in the St. Louis District. The Boston and New York Districts said results were "mixed," but Boston added that the majority of retailers cited soft year-over-year sales gains. Three Districts--Kansas City, Minneapolis and San Francisco--reported little change in retail sales. Philadelphia said sales in its District increased from April to May, but gains were "varied" among stores. The Atlanta District reported that sales rose at a "solid pace" but "some segments reported lower demand." Improving trends were reported by the Cleveland District, and the Chicago District said consumer spending continued to "increase modestly."

Most reports about auto sales suggested weakness, with particularly poor sales of SUVs and light trucks. Auto sales were reported as "sluggish" or "down" in the Chicago, Cleveland, St. Louis, and Philadelphia Districts. Atlanta reported that sales were "mixed," and Kansas City said auto sales were unchanged from last month but lower than a year ago. Sales increased in the Dallas and San Francisco Districts, but some dealers in the Dallas District reported sizeable excess inventory because sales were less than expected over the winter months. The Chicago and St. Louis Districts also reported that inventories were higher than desired, and the Philadelphia District said dealers had limited their orders to manufacturers to keep inventories in check. The Kansas City District reported that inventory levels were satisfactory.

Manufacturing

The manufacturing sector continued to expand quite strongly, but with more reports of softening than at the time of the last Beige Book survey. Strong activity was noted in the production of goods to supply the energy, semiconductor, and aerospace industries. Areas of weakness included production of agricultural equipment and autos. Slower demand for goods to supply residential building, most notably lumber, was mentioned by a few Districts, although the Atlanta and Dallas Districts reported demand for construction-related materials still remained strong overall.

Manufacturing activity was characterized as "strong" or "up solidly" in the Boston, Chicago, Dallas, and Kansas City Districts. The San Francisco District reported that activity expanded overall, with production of commercial aircraft near full capacity and capacity utilization of semiconductor manufacturers at or above 90 percent. Production was "steady to increasing" in the Cleveland District, and firms continued to report generally favorable conditions in the New York District. Activity continued to expand in the Minneapolis and St. Louis Districts. Two Districts--Philadelphia and Richmond--noted some softening or leveling of growth. The Atlanta District said activity remained mixed.

Services

The Boston, Dallas, New York, St. Louis, and San Francisco Districts report "strong" or "robust" activity throughout the service-producing sector. Demand for workers at temporary employment firms picked up in the Chicago, Dallas, and Richmond Districts, while contacts in the Boston, Dallas, and New York Districts indicated "steady" and "solid" activity. Business activity at information technology service firms grew at a steady pace in the Boston and San Francisco Districts, and firms in both Districts indicated an increase in hiring activity. Demand for health-care and professional services was vigorous in the San Francisco District, while demand for professional services in the Dallas District was "typical."

Demand for trucking, shipping, and rail services remained strong across the country, but companies cited difficulty finding and retaining drivers in the Atlanta and Cleveland Districts. The Boston, Chicago, and Dallas Districts indicated strong demand for air travel.

Reports from the tourism and hospitality industries remained upbeat. Tourism activity strengthened in the Boston, Minneapolis, New York, and Richmond Districts and remained solid in the Atlanta, Kansas City, and San Francisco Districts. The Chicago District reported steady tourist activity but noted that pre-bookings were slow. Hotel occupancies were strong in parts of the Atlanta, New York, Richmond, and San Francisco Districts, and the Atlanta District reported that gambling revenues were recovering.

Construction and Real Estate

Residential real estate markets continued to cool across much of the country--with most Districts reporting slower homebuilding and sales of existing homes. In contrast, commercial real estate activity continued to strengthen in most Districts. A few reports noted concern about too much building.

Some softening of the market for existing homes was reported by ten Districts--Chicago, Cleveland, Dallas, Kansas City, Philadelphia, Minneapolis, New York, Richmond, St. Louis, and San Francisco. Dallas and Richmond noted that activity remained quite strong, and Chicago reported slowing from high levels. San Francisco reports hot housing markets in Utah and parts of the Pacific Northwest. Several Districts said sales had weakened for some of the most expensive homes, except in the Dallas District where demand for lower priced homes "had dipped noticeably." Atlanta reported that residential sales were near year-ago levels in most parts of the District, but that sales weakened and inventories increased in Florida. The Philadelphia District said sales of homes in resort areas have declined sharply. The New York District reports a sharp deceleration in prices in the suburbs around New York City, but a tightening of the Manhattan rental markets.

Homebuilding slowed in most Districts--Chicago, Cleveland, Dallas, Kansas City, New York, Philadelphia, St. Louis, and San Francisco. The New York District reported that some homebuilders in New Jersey are withdrawing from the authorization process and allowing their options to build to expire, noting that increases in fuel and materials costs are pinching profits. Homebuilders in the Atlanta District reported that single-family home construction was near year-ago levels in most of the District, except in Florida, where sales slowed. The Atlanta District also reported that Florida condominium sales continued to weaken and several projects were cancelled.

Commercial real estate activity strengthened in nearly all Districts, with mostly positive reports about office markets. Commercial building "improved" in the Cleveland District. Office markets were steady or stronger in the New York City metro area, with scattered signs of accelerating rents. The Philadelphia District said vacancy rates have continued to decline in the region's office markets. The Richmond District reported "fairly strong" office markets. Demand for office space "edged up at a steady pace" in the Dallas District. Office vacancy rates fell and rental rates rose in most major markets in the San Francisco District.

Boston reported that downtown office real estate markets were improving but mostly at the expense of suburban markets. Demand for commercial real estate in the Chicago District continued to expand, but the pace of new commercial construction slowed, according to contacts, who said rents were too low to justify new construction.

The Kansas City District reported that commercial construction remained strong, but received a few reports that high material costs were resulting in the scaling down or postponement of some projects. Construction firms in the Philadelphia District reported that rising costs have caused some construction projects to be rebid or redesigned to reduce the amount of costly materials used. Some builders in the San Francisco District continued to face cost increases and minor project delays as a result of tight availability of skilled workers and selected materials, such as steel and cement.

The Philadelphia District reported growing demand for industrial space and an increase in construction of industrial buildings both on a speculative and build-to-suit basis. Demand for industrial properties was said to be gradually improving in the Dallas District. The Richmond District also reported growth in commercial leasing in the industrial sector.

Contacts in the Boston, Chicago, and Dallas Districts expressed concern about the level of investment in some portions of the real estate market. The Boston District reported that New England--and Boston in particular--continues to attract large volumes of commercial real estate investment, resulting in price increases that require "ambitious assumptions" to justify the transaction. The Dallas District noted growing concern about overbuilding of condominiums and town homes in Dallas, and contacts "fear that it will end badly." A contact in the Chicago District expressed concern about the potential for overbuilding of large distribution centers in Indiana.

Banking and Finance

Overall lending activity was mixed, and credit quality remained good across the nation. The New York, Chicago, and Atlanta Districts reported continued slowing in loan demand, while lending activity levels held steady in the Dallas, Kansas City, St. Louis, and San Francisco Districts. Only the Philadelphia District noted an increase in overall loan volumes over the past six weeks.

Demand for commercial loans increased or remained steady in most Districts, with only the Atlanta and Chicago Districts reporting a slowing in commercial lending activity. Bankers in the Dallas, and Richmond Districts said loan pricing was very competitive, and contacts in the Richmond District said they had to reduce margins to retain market share. On the consumer side, most Districts reported softening mortgage finance activity, while reports of other types of consumer loans were mixed. Demand for home equity loans weakened in the Chicago and Kansas City Districts but was up in the Cleveland and Philadelphia Districts. Refinance activity was categorized as "brisk" in the San Francisco District but declined in the Chicago, Kansas City, and New York Districts. Slower auto lending was reported by the Atlanta and Cleveland Districts.

Deposit growth was mostly steady, and some Districts noted an increase in interest rates on deposits. Delinquencies declined in the Chicago and New York Districts, but bankers in the Philadelphia District expect rising default rates if interest rates continue to rise. The Kansas City and St. Louis Districts reported no change in lending standards, while the New York District reported an easing in credit standards, especially for consumer loans.

Agriculture and Natural Resources

Agricultural conditions varied across the country. Spring rains boosted moisture conditions in parts of the Dallas and Minneapolis Districts, and most crops were off to a good start in the Chicago, Richmond, and St Louis Districts. Plantings were ahead of last year's pace in the Minneapolis, Kansas City, and St Louis Districts, while crop conditions improved in the Atlanta District. In contrast, a dry spell lowered winter wheat crop yields and was hurting cattle producers in parts of the Dallas and Kansas City Districts. Concerns about high fuel and fertilizer costs were reported by contacts in the Atlanta and Dallas Districts as well as the Minneapolis District, where agricultural lenders anticipated a decline in farm income in the second quarter.

The energy industry continued to show strong and expanding oil and gas activity in the five Districts that mention the sector--Atlanta, Dallas, Kansas City, Minneapolis, and San Francisco. The Dallas and Kansas City Districts noted that drilling activity is being constrained by shortages of equipment and labor. Expansion of coal-fired power plants, wind farms, and ethanol distilleries was reported as under way in the Minneapolis District. The Kansas City District also reported that a railway expansion is in progress that will allow more coal to be moved out of Wyoming's Powder River Basin to end users.

The Kansas City and Minneapolis Districts reported that overall mining activity is strong, with all open mines in the Minneapolis District producing at or near capacity.

Labor Markets

Labor markets continued to tighten across the country. Shortages of some types of skilled workers were reported by nine Districts--Atlanta, Boston, Chicago, Cleveland, Dallas, Kansas City, Philadelphia, Richmond, and San Francisco. Six of those Districts noted that the shortages had intensified--Atlanta, Boston, Cleveland, Dallas, Philadelphia, and Richmond. District reports mention a variety of skills that are in short supply, including truck drivers, some types of engineers, financial analysts, and oil and gas workers. The Minneapolis and New York Districts noted strengthening labor markets. In contrast, manufacturers in the Richmond District reported that hiring softened after several months of moderate payroll increases.

Salaries continued to rise, but wage pressures were reported to have intensified somewhat in only a few Districts--Dallas, Kansas City, and Philadelphia. The San Francisco District said wage growth remained rapid for selected worker groups with specialized skills. The Cleveland District reported an absence of any accumulating wage pressure outside of a few specific skills. Pay rates were not accelerating in the Boston or Chicago Districts.

The Atlanta District reported that shortages of affordable housing were hampering labor availability in South Florida and the Gulf Coast region.

Prices

Concerns about high or rising costs were expressed by business contacts across much of the country. Cost pressures were pushing up selling prices for manufacturers in several Districts, but few reports indicated that these increases were reaching the retail level. Four Districts--Boston, Cleveland, Dallas, and New York--cited rising selling prices for manufacturers, and just three Districts--Boston, Dallas, and Philadelphia--reported that retailers are having success raising retail prices.

Cost pressures increased in the Atlanta, Boston, Chicago, Cleveland, Dallas, Kansas City, New York, Philadelphia, and San Francisco Districts. Some firms in the Philadelphia District said their suppliers were including automatic price escalation in contracts to cover future increases in the cost of materials. The San Francisco District noted little or no change from the modest upward pressure on prices noted in the previous report. Only the Richmond District reported that raw materials prices increased less rapidly than in the last report.

Higher prices were reported for a number of items, with the products most cited including fuels, metals, petroleum-based products, and many building materials, such as concrete, steel, copper, and zinc. The most notable price decline was for natural gas. A number of Districts reported increases in fuel surcharges. In the New York District, fuel surcharges were being added with relatively little resistance from customers. Increases in delivery charges were noted by firms in all industries in the Philadelphia District. The Cleveland District reports that rising freight costs were affecting retailers.

Retailers in the Philadelphia District said they have raised retail prices significantly for some goods with large plastic or metal content, although they had not implemented major price increases for most lines of merchandise. Several retailers in the Dallas District said that they had passed cost increases through to higher selling prices. Retailers in the Boston District indicated that vendor prices continued to reflect increases for petroleum-related items, and many contacts reported being able to pass on some price increases to consumers. The Atlanta District reported that firms' ability to pass on higher costs to customers remained mixed, citing slowing demand and strong competition restraining price increases. Five Districts--Chicago, Cleveland, Kansas City, New York, and San Francisco--reported little change in retail prices since the previous reporting period. The Richmond District reported that retail price growth eased slightly in May.

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First District--Boston

The First District economy continues to expand. Manufacturers and software and information technology services firms indicate that revenues are up solidly from a year ago, with many manufacturers reporting double-digit gains. Companies in the staffing industry also report steady revenue growth. Retailers' results, by contrast, are mixed, with the majority citing softer year-over-year sales gains. Respondents say the downtown office real estate picture is improving, but mostly at the expense of suburban markets. Labor markets continue to tighten in New England, with various professional and technical positions reportedly difficult to fill; pay rates, however, are not said to be accelerating. Many business contacts continue to express concern about high or rising input costs, but report mixed success in raising their own prices.

Retail and Tourism

First District retailers cite mixed results for the months of April and May. One contact in the restaurant industry reports that same-store sales were up almost 5 percent for company-operated restaurants and less than 1 percent for franchise-owned restaurants in the quarter ending in April; they were flat in May. An office-supplier notes that sales gains in the quarter ending in April were a little softer than earlier in the year, but still solid, with same-store sales 1 percent ahead of year-earlier levels; total company sales were up 9 percent due to new store openings. An electronics retailer reports that sales have been flat or slightly down, while a drugstore chain registered a robust increase in same-store sales over May 2005. Another contact notes that sales of sporting goods, home goods, children's and women's apparel have been strong, but that men's apparel has been weak. Most retailers are cautiously optimistic, and remain concerned about increasing fuel costs and rising interest rates.

Inventory levels are also mixed, with some retailers reporting more inventory than desired, while others cite a need to boost inventories. Vendor prices continue to reflect increases for petroleum-related items, while many contacts report being able to pass on some price increases to consumers. Employment is varied, with one contact eliminating several positions because of weaker than expected sales, and several others increasing headcount due to acquisitions and seasonal hiring. Most retailers report that they are in line with capital spending plans for the year, with spending primarily focused on new stores.

A travel and tourism contact reports that business is so robust in Boston, the area is on pace to exceed the benchmark high levels established in 1999-2000 in every metric except average room rates. Business travel remains strong, but is still cost sensitive. Advanced bookings are also solid. International travel seems to be thriving, and the opening of several new major hotels is expected to further spur demand. Rising gas prices and inflation remain a concern.

Manufacturing and Related Services

Most First District manufacturers and related services providers report that first quarter and early second quarter sales were higher than a year ago. Many had double-digit revenue gains. Among the strong performers are firms in the medical supplies, semiconductor, aerospace, and information technology equipment industries. A couple of manufacturers note new weakness in some segments of retail, but others say their consumer-oriented business continues to be strong.

About one-half of the respondents express concern about high or rising transportation and input costs, especially brass, bronze, titanium, and oil derivatives. Some manufacturers have seen input costs decrease as a result of downward trends for technology products or greater foreign sourcing. About one-half of the contacted manufacturers have raised their selling prices in recent months or plan to do so shortly. On the whole, they report that commercial and industrial customers have been more accepting of price increases than retail purchasers.

Most manufacturers report little change in their U.S. headcounts, apart from selective additions in professional, technical, and sales positions. Financial and supply-chain management positions are said to be hard to fill. A couple of firms are increasing production worker hours in the U.S., but others continue to shift employment (both production and non-production) to lower-cost locations. Average pay increases for 2006 are mostly in the range of 3 to 4 percent.

Domestic capital spending plans are quite varied, ranging from no change or "tight" to substantial increases relative to last year. Some manufacturers are investing to expand their product development or production, while others are implementing IT system upgrades or installing more modern equipment.

Most manufacturers are upbeat about the demand for their products and services through the remainder of 2006. To the extent they see risks, their concerns chiefly center around the outlook for consumer spending and housing markets, although some mention possible adverse effects on their own margins or the economy at large from high or rising commodity prices.

Staffing Services

Business is steady for responding First District staffing firms. Most contacts describe business in the first two months of Q2 as "pretty good" or "consistent," reporting revenue growth in the low- to mid-single digit range. One contact says that, while business has been strong in Q2, there has been "no rapid-fire growth." Another reports that revenues are currently up 6 percent over last year, but have shown "no real growth since February." Only one respondent reports year-over-year revenue growth in the double digits. At the other extreme, a contact indicates that his firm's revenues are down 50 percent from last year due to structural changes within the firm and the region's increasing cost of doing business.

The consensus among contacts is that demand for labor is solid but jobs are becoming harder to fill. Labor supply continues to be tight, particularly for high-end clerical and administrative positions, skilled manufacturing jobs, and medical positions. More than one contact reports that even as the availability of skilled labor is diminishing, clients are taking more time with the hiring process or "setting the bar too high," and often losing qualified candidates to other companies. Some respondents also indicate that clients are unwilling to pay higher bill rates despite increasing recruiting costs and upward pressure on pay rates for skilled workers. All contacts note an increase in demand for permanent labor and a shift in the role of staffing companies away from the "temp" side to more comprehensive staffing services, including human resources and project management services. Contacts expect more of the same for the remainder of the year--steady demand for staffing services coupled with a continued tightening in the supply of skilled labor, resulting in increasing pay rates and bill rates.

Software and Information Technology Services

Business appears to be growing steadily at software and IT services companies in the First District, with firms reporting year-over-year quarterly revenue increases ranging from low single digits to 14 percent in the most recent quarter. Contacts state that the market is competitive and, as a result, the majority have kept their prices unchanged. Two software companies report that the increased use of off-shoring within the software and IT services industry has made it "imperative to have a component of off-shoring" priced in to remain competitive.

Most software and IT services firms are increasing their headcounts between 5 percent and 10 percent. All firms with plans to hire report a tightening in the labor market in New England, especially for technical positions. Several firms note increased turnover and upward pressure on wages as employees now have more job opportunities. Respondents report annual wage increases between 3 percent and 10 percent. Most software and IT services contacts indicate they are holding capital spending fairly level; however, a few have increased outlays to expand facilities and upgrade equipment.

First District software and information technology firms expect either steady or accelerated growth for their companies in the third quarter. Two companies say the biggest challenge to growth is finding people to fill open positions at reasonable cost.

Commercial Real Estate

Contacts across New England report improved conditions for centrally located office space. Boston's downtown vacancy rate has declined to nearly 10 percent, with availability (vacancies plus sublease space) of 12 percent to 13 percent. Correspondingly, rents are moving upward. Contacts in Boston attribute declining city vacancies not to corporate expansion or job growth, but instead to former suburban tenants taking advantage of low pricing to lease city space. In contrast to central business district office space, suburban office markets and light industrial markets are facing some difficulty. Boston suburbs feature office availability rates 5 to 10 percentage points higher than the city center.

New England--and Boston in particular--continues to attract large volumes of commercial real estate investment; contacts characterize the level of interest as being "off the charts" or "incredible." They note that the resulting price increases continue to compress commercial real estate yields. One contact worries openly that commercial real estate properties are being "priced to perfection" and may not be able to perform to the ambitious assumptions implicit in their transaction prices.

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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. Businesses report increasingly widespread cost pressures, but thus far there has been no broad-based acceleration in consumer prices. The labor market has shown further signs of strength since the last report, except in the construction industry, where some slackening is reported. On balance, retailers report that sales remained close to plan since the last report, while tourism activity has strengthened. Firms involved in goods production and distribution report increasingly favorable business conditions in May. More generally, however, business and household surveys suggest increased concern about the outlook for the second half of the year. Housing markets showed further signs of softening in April and May, though Manhattan's rental market is reported to have tightened. However, office markets across the New York City metro area were steady to stronger in April and May, with scattered signs of acceleration in rents. Finally, bankers report across-the-board weakening in loan demand, particularly for consumer loans, as well as easing in credit standards and lower delinquency rates.

Consumer Spending

Retailers report mixed results for May, with department stores indicating that sales were on or above plan but discounters reporting sales below plan. Retail contacts continue to note fairly brisk demand for higher-end merchandise, but weakness in lower-end lines. Sales of home furnishings continue to be one of the more sluggish categories. Overall, inventories are reported to be at favorable levels, and selling prices remain relatively steady.

Tourism activity in New York City has picked up since the last report: Manhattan hotels report strong business in April, with occupancy rates rising by more than the seasonal norm and room rates up nearly 11 percent from a year earlier. Similarly, Broadway theaters report strong attendance for both April and May, following a brief slump in March--attendance rose 4% from a year earlier, while total revenues were up by well over 10 percent in both months.

Consumer confidence in the region, which reached a nearly 4-year high in March, declined moderately in both April and May, based on the Conference Board's survey of Middle Atlantic state (NY, NJ, Pa) residents. There was a pronounced drop in consumers' expectations, but their assessment of current conditions remained fairly positive.

Construction and Real Estate

The region's housing market has shown mixed but generally softer signs since the last report. New Jersey homebuilders report that they continue to adjust down their expectations for the local housing market; some builders in the midst of the authorization process are reported to be withdrawing and allowing their options to build to expire. One industry expert is now advising appraisers to assume a flat to downward trend in prices, as opposed to an upward trend. Cumulative widespread increases in fuel and materials costs are reported to be pinching homebuilders' profits; however, builders report some slackening in labor demand and little or no upward pressure on wages.

The market for existing homes has also shown further signs of softening since the last report, but observers differ on the nature and extent of a slowdown. In New Jersey, the inventory of unsold homes continues to be much higher than a year ago, with the increase reported to be concentrated at high end of the market (over $500,000). The New York State Association of Realtors reports some weakening in sales activity in March and April, and notes a sharp deceleration in prices in the suburbs around New York City. A major Manhattan appraisal firm reports a fairly large supply of apartments on the market and less of a spring pickup in co-op and condo sales than usual this year. However, a major Manhattan real estate firm notes that apartment prices have held steady and attributes the growing inventory of homes on the market largely to a surge in newly constructed units coming onto the market, rather than weakening demand. Manhattan's rental market has reportedly strengthened since the last report, reflecting a lack of new rental construction, a dwindling number of listings and continued strong demand.

Office markets across the New York City area were steady to stronger since the last report, with vacancy rates edging off and rents accelerating in some areas. In April and May, office vacancy rates were little changed in northern New Jersey, southwestern Connecticut and Westchester County, and down moderately in Long Island and Midtown Manhattan. Lower Manhattan's vacancy rate rose, due to an increase of 1.7 million square feet of available space with the opening of 7 World Trade Center in May.

Other Business Activity

A major NYC employment agency, specializing in office jobs, reports steady and strong job market conditions since the last report. This contact also notes that salary offers continue to run more than 10 percent ahead of a year ago while the qualifications of available job applicants are noticeably weaker than a year ago. Purchasing managers in the Buffalo and Rochester areas report some strengthening in general business conditions and a pickup in hiring activity. More broadly, New York State manufacturers continue to report generally favorable business conditions in May, though they express somewhat less optimism about the six-month outlook than they have for some time. Firms outside the manufacturing sector also report strong business activity but a number of companies in shipping and financial services express increased concern about prospects for the second half of 2006. Both manufacturing and non-manufacturing firms report increasingly widespread price pressures and expect further boosts in the months ahead. A trucking industry expert notes that business remains fairly strong and that firms have been able to add fuel surcharges with relatively little resistance from customers.

Financial Developments

Small to medium-sized banks in the Second District report decreased demand for all types of loans since the last report--most notably for consumer loans. Bankers also report increasingly widespread softening in refinancing activity. Credit standards eased, particularly for consumer loans, with no banker reporting tightened standards, and 24 percent reporting eased standards; this is the most widespread easing reported on consumer loans since we began asking this question in 1997. Bankers again report broad increases in both loan rates and deposit rates. Finally, banks report lower delinquency rates across all loan categories: in each category, more than 20 percent of firms report declines in delinquencies, while fewer than 4 percent report increases.

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Third District--Philadelphia

Overall economic conditions in the Third District improved in May. Labor markets tightened. Manufacturing increased during the month, although the pace of growth eased. Retail sales of general merchandise rose, and the year-to-year gain improved compared with April; however, auto sales declined. Bank lending has been increasing, although demand for residential mortgages has softened. Residential real estate activity slowed, but commercial real estate markets continued to firm.

Third District business contacts generally expect business activity in the region to continue to expand at a moderate rate, but they anticipate further slackening in auto sales and residential real estate. Manufacturers expect the rate of growth to pick up during the second half of the year. Retailers anticipate steady gains in the next few months, although for the longer term they are concerned that if interest rates and gasoline prices remain at current levels or increase, this will dampen consumer spending. Auto dealers expect sales to remain sluggish through the rest of the year. Banks anticipate a moderate increase in business and personal lending, but they forecast a further decline in mortgage lending for home purchases. Contacts in residential real estate expect home sales and construction to fall further this year. Contacts in commercial real estate foresee an increase in demand for office and industrial space, but they expect construction to ease.

Manufacturing

Manufacturing activity increased in May, but the pace of expansion slowed from April. Around one-half of the Third District manufacturing companies contacted for this report said that shipments and new orders in May were level with April; only a few more firms reported increases for the month than reported decreases. On balance, area manufacturers reported virtually no change in order backlogs, although delivery times rose slightly. Demand picked up in May for lumber and wood products, paper products, metals and metal products, and industrial equipment; demand softened for transportation equipment, industrial instruments, and non-metallic industrial materials.

Overall, manufacturers expect the pace of growth to improve in the months ahead. Half the firms contacted in April expect their shipments and orders to increase during the next six months; about one-fourth expect decreases. On balance, capital spending plans among District manufacturers call for modest increases in expenditures.

Retail

Most of the retailers contacted for this report indicated that sales increased from April to May. Although the gains varied among stores, on balance it appeared that the year-over-year increase in May was somewhat stronger than the increase in April. Area merchants said warm weather prompted purchases of summer apparel and other seasonal merchandise. Third District retailers expect sales to grow at about the current rate into the summer months. However, they believe gains in consumer spending will eventually ease if higher gasoline prices and interest rates persist.

Auto sales in the region declined in May, compared with April and with May of last year. Dealers said foreign models continue to have better year-to-year sales comparisons than domestic models, and that luxury car sales have been propped up by an increase in leasing. Inventories were held in check because dealers have limited orders to manufacturers. The consensus among auto dealers in the region is that sales will be sluggish for the rest of the year.

Finance

The volume of loans outstanding at Third District banks rose from April to May, according to commercial bank lending officers contacted for this report. Commercial and industrial lending increased for most banks. Consumer lending also rose, with gains in credit card lending and home equity loans. Demand for residential purchase mortgages continued to ease. Deposit interest rates were rising amid strong competition, but most of the banks surveyed for this report said their net interest margins have been steady.

Bankers in the District expect continued growth in business and consumer lending in the months ahead but foresee further weakening in residential mortgage lending. Commercial bank loan officers contacted for this report generally indicated that credit quality remained good for both consumer and business loans. However, some bankers expect some borrowers to face repayment difficulties if interest rates continue to rise.

Real Estate and Construction

Commercial real estate firms reported that vacancy rates in the region's office markets have continued to decline in the past few months. Rents have shown little change, overall, moving up somewhat in some markets and edging down in others. Commercial real estate contacts expect further gradual tightening of the region's office markets this year if the local economy continues to expand at its current rate. However, they expect the supply of office space in the region to increase this year and next as buildings under construction are completed. Additionally, corporate consolidation is expected to result in some currently leased space coming on the market in the months ahead. Demand for industrial space in the region continued to grow, and there has been an increase in the construction of industrial buildings on both a speculative and build-to-suit basis.

Residential real estate agents and homebuilders generally reported a slowing in sales in May, compared with the pace set earlier this year and with sales in May of last year. Real estate contacts noted that the number of existing homes for sale and the time they are on the market have continued to increase. Homebuilders and real estate agents expect sales this year to be lower than in 2005, and they expect price appreciation to slow significantly. Although home builders and real estate agents described the slowdown in sales as gradual in most parts of the region, they indicated that sales of homes in resort areas have declined sharply.

Prices and Wages

Business firms in the Third District reported continuing increases in the costs of raw materials and intermediate goods. Manufacturers continued to face price increases for lumber, metals, petroleum-based products, and chemicals. They also noted some shortages and delivery delays for metals and metal products, wood products, and electronic components. Retailers indicated that they have raised retail prices significantly for some goods with large plastic or metal content, although they have not implemented major price increases for most lines of merchandise. Construction firms reported continued high prices and delivery delays for some materials. In response to rising costs, some construction projects have been rebid or redesigned to reduce the amount of costly materials used. Some firms said their suppliers were including automatic price escalation in contracts to cover future increases in the cost of materials. Firms in all industries noted increases in delivery charges.

Employers in a range of industries reported that labor markets remain tight, and college placement offices generally indicated that recruiting activity picked up this year compared with last year. Most area firms indicated that wage and salary increases implemented recently have been slightly greater than they were last year. Employers reported having greater difficulty filling positions requiring skilled labor and for some professional specialties, and they have raised salaries more for these workers than for others. Employers also noted an increase in quit rates as employees are finding higher-paid positions easier to obtain. In some parts of the region seasonal jobs have been difficult to fill, and wages for these jobs have increased significantly compared with a year ago.

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Fourth District--Cleveland

The District's economy continued expanding in late April and May, as it has throughout the year. Most manufacturers reported steady to increasing production in recent weeks. Retailers also reported better-than-anticipated increases in sales relative to this time a year ago. Demand for trucking and shipping services remained strong and broad-based. While commercial building continues to recover, homebuilding has slowed. Some of this slowdown is reflected in weaker consumer loan demand at District banks, though commercial borrowing continues to be steady.

On hiring, more firms reported that they are looking to add workers, and contacts from the staffing-services industry said that some types of skilled workers remain in short supply. Nevertheless, outside of a few areas, there were no reports of any accumulating wage pressure. Nonlabor input-cost increases, however, were widely reported. Specifically, contacts cited increases in the prices for petroleum-based products, some building materials and metals, and natural gas. Attempts to recover these increases in costs varied by industry; in general, about half of the contacts from construction and manufacturing firms reported attempts to increase prices in response to cost changes, while reports of retailers' increasing their prices were few.

Manufacturing

Contacts at the District's durable goods facilities generally reported that production was above year-ago levels at the end of May. Most contacts, including those in the steel industry, expect this trend to continue into the summer months. One industry with weaker current and prospective production was autos: At District auto assembly plants, production fell notably from last year's levels. Regarding capital expenditures, responses were roughly evenly divided between those firms that planned to increase spending in the next six to twelve months and those that did not. In terms of hiring, half of respondents reported hiring in April and May, but only a quarter plan any additional hiring in the near future. Wage pressures are not a concern. Input costs, however, increased in late April and early May, notably for petroleum-based products and metals. A quarter of those reporting indicated that they successfully increased prices in response.

Production at the District's nondurable producers improved in April and May but remains roughly the same as at this time last year. Several contacts reported an increase in new orders. Hiring and planned increases in capital spending were limited. Though nondurable goods producers also reported price increases in energy-related items, most contacts reported that their overall input costs were stable. According to contacts, firms that attempted to increase their prices had more success passing price increases along to smaller customers than to larger customers.

Retail

District retailers generally reported improving sales trends through the six weeks ending in May. Specialty apparel retailers reported higher sales than at this time last year. Sales at the District's drug stores were also above last year's levels, though sales trends for these retailers were less than the national average. Lastly, department store sales were a bit below last year's levels, but better than anticipated.

Some segments, however, did see a softening. Reports from the District's discounters indicated that their sales were slightly weaker than anticipated, though sales still grew relative to a year ago. Some of this weakness was attributed to increases in gasoline prices. Several contacts suggested that consumers were more value conscious than in the recent past and that consumers may have been trying to limit spending to necessities. Increases in gasoline prices also affected retailers through rising freight costs; nevertheless, retailers' prices remained relatively flat.

Most auto dealerships reported sluggish sales in late April and early May, though sales of foreign nameplates fared significantly better than their domestic counterparts. In response, some manufacturers are attempting to spur sales with incentives. For instance, in early June, Ford announced a new incentive offer, wherein buyers would receive $1,000 for gasoline purchases.

Construction

New home sales were mixed in April and early May compared to the first quarter, with more contacts reporting declines than increases. Second-quarter sales for most builders have declined on a year-over-year basis. About a quarter of the builders indicated they have increased their base prices in the last few months to offset increases in materials costs. However, a slightly larger proportion increased their discounts or incentives. Sales over the next several months are expected to fall from last year's levels. Many contacts reported significant increases in plumbing and electrical costs due to the increase in copper prices. Most contacts said subcontractors are less busy and more available than usual, and several builders reported reducing their payrolls, possibly pointing to net reductions in the industry's overall employment levels.

Almost all commercial contractors reported that business has tended to improve throughout 2006 and is better than at this time in 2005. Contractors are optimistic about the remainder of 2006. Building segments reportedly doing well include office construction, particularly for professional service and health care concerns, and public projects. Contacts reported rising materials costs, notably for copper, concrete, drywall, and petroleum-related products. As a result, almost all contractors are planning to increase prices sometime in the future. About half reported increasing staff sizes, some significantly. Subcontractors are also seeing an increase in work and are charging higher rates.

Banking

At District banks, commercial loan demand was steady while consumer loan demand was soft in late April and May. Home equity loans were up, while auto-loan demand continued to be weak. The mortgage market softened in May and is expected to remain this way for the remainder of 2006. Credit quality remained strong for both consumer and commercial customers. Core deposits changed little at most banks. At this time, most bankers expect 2006 to be a challenging year due to narrowing net-interest margins.

Transportation

Demand for trucking and shipping services remained strong through the six weeks ending May. Higher fuel costs concerned contacts, even though trucking companies have been able to maintain their surcharges. Carriers continued to report difficulty attracting and retaining drivers; however, few firms planned to increase wages. As previously reported, capital spending in the industry is strong, as firms attempt to purchase trucks that don't need to meet impending EPA guidelines.

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Fifth District--Richmond

District economic activity grew more slowly in recent weeks, as a continued decrease in housing activity was joined by some downshifting in the manufacturing and retail sectors. District housing markets, while still relatively strong, continued to soften as sales slowed in many areas; real estate agents anticipated a further downward drift in prices. In May, factory output nearly flattened following several months of growth, with new orders decelerating sharply as well. Services firms and tourist establishments noted somewhat faster growth in their revenues, but retailers reported weaker sales. Despite evidence of softening economic activity, District labor markets remained strong outside of decreased hiring by factories. On the price front, upward pressures pulled back somewhat in May, though manufacturers told us that sharply higher input prices squeezed margins and many would attempt to raise their prices going forward. On District farms, generally dry weather assisted planting efforts but had little negative impact on crops as yet.

Services

Revenues at services firms grew at a faster pace since our last report. Financial services contacts in Richmond, Va., and Baltimore, Md., told us that business remained strong, though they noted increasing caution among their clients as interest rates rose and real estate markets slowed. A North Carolina-based trucking contact said customer demand remained solid and that a new distribution center near Greensboro would likely boost the area's economy going forward. Turning to prices, contacts at service-producing businesses reported that the pace of increase moderated somewhat in May, but they looked for price growth to quicken in coming months.

Retail

Retail sales generally grew at a slower pace in May, though some contacts noted that sales began to pick up at mid month as warmer weather took hold. In South Carolina, contacts at two large building supply businesses said the pace of sales declined in May as construction activity slowed and energy prices rose. A chain department store manager in Virginia Beach, Va., said business at her store had been good, but that stores at other locations had not done well in May. In contrast, a central North Carolina department store manager noted that his sales firmed around Mothers Day and continued strong for the remainder of the month, leaving his non-seasonal inventory "a little light." And a contact at a regional hardware and building supply chain added that his late May revenues were boosted by sales of generators and shutter-resistant windows ahead of the hurricane season. Contacts reported that retail price growth eased slightly in May.

Manufacturing

District manufacturing activity flattened in May following a marked pickup in March and April. Shipments, new orders, and capacity utilization grew more slowly last month, while employment and order backlogs contracted. Among industries, furniture, rubber and plastics, and transportation equipment reported the biggest declines in output. Manufacturers noted a softening in hiring after several months of moderate payroll increases. In addition, the average workweek declined, although wages maintained the solid trend of recent months. Contacts said raw materials and finished goods prices increased less rapidly than in our last report. But manufacturers remained alert to increasing price pressures, and many planned to raise their prices in coming months. A North Carolina plastics producer, for example, said that his company's margin was too thin and the firm would work to get their prices up.

Finance

District bankers reported a dichotomy between residential and commercial lending. Demand for residential mortgages decreased while commercial lending remained strong. Most mortgage lenders attributed the deceleration in residential demand to rising interest rates. A Charleston, S.C., banker noted that increasing mortgage interest rates had slowed lending, especially on second mortgages and re-financings. In contrast, commercial lenders reported activity remained fairly robust, noting that loan pricing remained highly competitive. Typical of the reports was that of a Charleston, W.Va., lender who said that his bank "sacrificed some on the yields in order to maintain market share."

Real Estate

Residential real estate agents across the Fifth District reported that housing markets remained generally strong, though sales, traffic, and prices continued to slow in some areas. Real estate agents in Odenton, Md., and in Washington, D.C., each reported slower home sales. The Washington, D.C., agent reported a continued decline in contracts and in buyer traffic. He told us that residential re-sales were down sharply, and that market inventory had tripled from year-ago levels. In contrast, a realtor in Greensboro, N.C., reported that home sales remained "pretty good," and Richmond and Virginia Beach, Va., agents reported healthy activity though the properties were not moving as quickly as a year ago. Most real estate agents told us that prices were holding steady although there was some indication that softening was becoming a bit more widespread. Low- to middle-price homes continued to be the best sellers throughout the District.

Commercial real estate agents reported continued growth in leasing activity. Gains were generally concentrated in the industrial sector, while office and retail leasing also remaining fairly strong. Agents reported little change in vacancy rates, which continued to be tight across the District. A retail contact in Richmond, Va., reported that there had been "a lot of absorption due to a lack of major projects." Agents also noted an increase in rent, especially for office space.

Tourism

Tourism activity strengthened since our last report. Contacts at hotels along the District's coast told us that bookings for the Memorial Day weekend--aided by near-perfect beach weather--were much stronger than a year ago. Contacts at mountain resorts in Virginia and West Virginia was also stronger. A manager at a mountain resort in Virginia said demand remains

so strong, they are offering fewer discounts. In contrast, a hotelier at Virginia Beach indicated that she had to offer more discounts on selected rooms in order to fill their hotel.

Temporary Employment
Temporary employment firms in the District generally reported stronger demand for workers in April and May. An agent that serves Washington, D.C., and Maryland continued to report that they experience a "generally hot economy," making it more difficult to find qualified workers. Likewise, in Raleigh, N.C., an agent told us that a pick-up in the local economy had boosted the demand facing his firm, but a lack of qualified workers could hamper their ability to ramp up production. High-end administrative and specialty skills, clerical, and forklift skills were highly sought.

Agriculture
Dryer-than-normal weather widened the planting window for District crops in recent weeks. Cantaloupe, tomato, and watermelon plantings were well ahead of schedule in South Carolina, and great progress was made in planting peanuts and soybeans in Virginia. Despite the dry conditions in some areas of Virginia and the Carolinas, agricultural analysts characterized crop conditions as "fair to good" throughout the District. In addition, with drier conditions, livestock and pasture conditions deteriorated somewhat in South Carolina but were reported to be good in West Virginia.

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Sixth District--Atlanta

Reports from Sixth District business contacts were mixed in April and May. While most retail merchants indicated that sales rose at a solid pace and expressed an upbeat near-term outlook, some segments reported lower demand. Auto sales were varied, and dealers noted that sales of SUVs and large trucks were especially soft. Residential construction remained steady with sales near year-ago levels in most parts of the District. However, sales weakened in Florida, especially in the condominium market. Nonresidential construction advanced at a modest pace, and factory activity was mixed. Regional transportation companies continued to report strong demand for their services, and Florida's tourism industry posted good results in the spring. Bank loan demand continued to slow in parts of the District. Employers in several industries noted difficulty in obtaining skilled workers. Upward cost pressures were reported in many industries, whereas the ability to pass on these higher costs to customers remained mixed.

Consumer Spending
Most District retail contacts reported healthy levels of sales and traffic in April and May. Total sales were described as being above year-ago levels. Merchants near Katrina-damaged areas continued to report very strong sales because of the influx of evacuees. Inventories were described as a bit heavy overall, but most merchants were still comfortable with their position, and continued to express a positive near-term outlook. The weakest retail reports came from discount retailers and restaurants. District auto sales were mixed in April and May. Dealers noted that sales of SUVs and large trucks were soft, while more fuel-efficient models performed better. Most contacts noted that demand for compact and hybrid models was strong and that inventories were light.

Real Estate
Homebuilders and residential real estate contacts reported that single-family home construction and sales were near year-ago levels in most parts of the District. However, Florida reports noted slowing in both construction and sales in April and May. Inventories of homes for sale in Florida remained higher than at the same time last year. In addition, Florida condominium sales continued to weaken with several project cancellations reported. Florida homebuilder contacts anticipated that new home sales and construction would remain near current levels, while Realtors expected further slowing in home sales. Some parts of Katrina-damaged areas in Mississippi noted a modest improvement in residential construction activity, and some demolition work had begun in the New Orleans area.

Gradually declining vacancy rates and positive absorption indicated healthy demand in nonresidential real estate markets across the District. However, construction has only picked up modestly according to most contacts. The pace of nonresidential redevelopment in hurricane-hit areas remains modest, although some parts of the Mississippi coast were further along.

Manufacturing and Transportation
Manufacturing activity remained mixed in April and May. Suppliers of construction materials continued to report strong demand. The auto production industry posted varied results. Another foreign auto parts supplier chose a District site for its first U.S. factory which will create 250 jobs. However, lower sales of some large SUVs and trucks have led to production cutbacks at several District assembly plants. Textiles also remained under pressure; a large regional textile firm will permanently close its factories in the District this summer, and approximately 2,000 jobs will be eliminated as a result. Several manufacturing firms reported that they were hesitant to move ahead with expansion plans because of uncertainties regarding input prices and future demand.

Strong demand for truck and rail services has continued to benefit most regional transportation companies. Generally, pricing has remained firm, allowing most trucking companies to recover part of the higher fuel costs. Driver shortages, especially for long haul truckers, have continued to cloud the otherwise favorable business outlook.

Tourism and Business Travel
The tourism industry posted positive results in April and May, but the outlook is uncertain. Contacts reported that tourism in South Florida was booming, especially among the five-star properties. Miami hotels reported very strong occupancies and room rates. A record number of people are expected to visit Orlando theme parks by the end of the year. However, Florida tourism officials remain wary as the hurricane season approaches. Some cruise lines out of Miami promoted discounts as much as 20 percent compared to last year's prices on late summer cruises in the Caribbean, reportedly because of hurricane fears.

Mississippi's coastal casinos continued to rebound. Mississippi Gulf Coast gaming revenues in April were back to approximately 60 percent of year-ago levels. The largest impediment reported for the tourism industry there is the scarcity of hotel rooms in the area.

Banking and Finance
Banking conditions in the District remained largely favorable. However, loan demand softened in some areas, led by a decline in the volume of mortgage applications. Some contacts also noted slower automobile and C&I lending. By most accounts, credit quality and deposit growth remained strong.

Employment and Prices
Contacts continued to report tight labor markets in many areas. A growing number of employers expressed difficulty in attracting new employees to South Florida, reportedly because of housing affordability issues. A shortage of housing has also hampered labor availability in the Gulf Coast region.

Most reports note continuing upward price pressures, especially for building materials and energy-related goods. Builders reported that prices for concrete, steel, copper, and zinc continued to move higher. High crude oil prices have pushed up the costs of petroleum-based goods such as PVC, roofing, and asphalt. Several contacts in coastal areas noted higher insurance costs. Despite these pressures, however, the ability to pass on higher costs to customers remained mixed. Slowing demand and strong competition were the most often cited reasons for not being able to raise prices.

Agriculture and Natural Resources
Improved weather conditions helped most District crops. Cotton conditions were generally improved, and sugarcane production is projected to recover from last year's hurricane damage. Meanwhile, poultry prices remained down because of weaker foreign demand. Prospects for oil and natural gas production from the Gulf of Mexico improved as the largest hurricane-damaged platform came back online, and is expected to reach full pre-Katrina production levels by the end of June.

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Seventh District--Chicago

Economic activity in the Seventh District continued to expand at a moderate pace during April. Spending by both consumers and businesses increased at rates similar to those in the last report. Overall labor market conditions were little changed, with small gains in employment on net. Manufacturing activity remained strong. Residential construction and real estate activity softened. Demand for commercial real estate space continued to expand, however the pace of new commercial construction slowed. Mortgage demand was down, while the expansion in commercial lending continued at a slower pace than in the last report. Nonlabor input cost pressures intensified in April and May, while increases in retail prices and wages were similar to the previous reporting period. Contacts reported that planting went well in most of the District and that the growing season was off to an excellent start.

Consumer Spending
Consumer spending continued to increase modestly in April and May. Retailers in Illinois and Indiana reported that sales were up modestly from a year earlier, while those in Michigan said that sales have been "inconsistent." Apparel sold well, helped by favorable weather in the region. Demand for lawn and garden items and electronics increased as well. High gasoline prices have reportedly dampened spending growth; one contact in the Chicago area said that fewer people were willing to drive to the city for weekend shopping trips. Retail inventories were at desired levels. Auto dealers said that sales of new Big 3 vehicle sales were down but sales of foreign nameplates were up. Domestic new vehicle inventories were above desired levels. Dealers reported that service activity had softened, due to the slower pace of new vehicle sales in recent months. A restaurant chain reported slower year-over-year gains in sales. Tourism was steady in the District, though pre-booking activity was sluggish.

Business Spending
Business spending and hiring expanded again. For the most part, capital spending continued to increase at similar rates as in the previous reporting period. One retail chain said that their purchases of high-tech equipment were unchanged from a year ago but that their overall capital spending had increased modestly. A manufacturing contact reported that the increase in their capital spending was occurring offshore. Freighthauling continued to expand overall, though one contact noted softer growth in shipments to discount retailers. Business travel to Chicago was up noticeably, helped by a large number of conventions. Overall labor market conditions were little changed, with small gains in employment on net. One contact in Illinois characterized the growth in hiring as balanced between high- and low-wage jobs. Factory employment ticked up. Shortages of skilled manufacturing workers persisted, and one contact noted that manufacturing firms were holding job fairs after abandoning the practice several years ago. A temporary help firm said that labor demand in the District increased modestly again, but noted that they had seen some weakening in billable hours growth nationwide in the past two weeks.

Construction and Real Estate
Construction and real estate activity was mixed by both location and market segment. Residential activity continued to slow from high levels in most areas. Contacts in Iowa and Michigan said that the demand for higher-priced homes had slackened most. Most builders and real estate agents indicated that the supply of new and existing homes for sale was growing and that homes were staying on the market longer. In addition, new home construction and other residential development activity slowed in most areas. Demand for commercial real estate space continued to expand, however the pace of new commercial construction slowed. A commercial contact in Chicago said: "Lots of money is still available for real estate, but most of it is going after existing buildings. Rents are too low to justify new construction." Commercial vacancy rates were little changed overall. One contact, however, expressed concern about the potential for overbuilding of large distribution centers in Indiana. Net absorption of office space in Chicago continued at a solid pace, and demand was broad-based. Contacts in Indiana reported strengthening demand for industrial space.

Manufacturing
Manufacturing activity remained strong during April and May. Demand for heavy equipment continued to be solid, driven by mining, energy, and construction demand. In contrast, orders of agricultural equipment weakened, and one industry analyst expected sales to be down slightly for the year. Heavy-duty truck orders have begun to tail-off, largely because order books are full for 2006 and there are no more spots to pre-purchase trucks before new EPA standards go into effect at the beginning of next year. Industry analysts said medium-duty truck order books for 2006 had filled by the end of May and expected orders to fall off precipitously. Revenues and order backlogs were up for many toolmakers, and brisk quoting activity suggested continued strength going forward. The sentiment of the toolmaking industry was "ecstatic," according to one contact. Steel producers reported further growth in demand from all markets; the strongest demand was for plate steel for oil pipelines. Steel inventories were below desired levels. Wallboard production continued to edge up closer to full capacity.

Banking and Finance
Lending activity moderated further. Bankers noted additional declines in mortgage applications for both purchases and refinancing. Demand for home-equity loans weakened as well, which was attributed to slower increases in home values. Mortgage spreads remained tight, though one bank saw a marginal widening in recent weeks. Reports on household credit quality were favorable, with mortgage delinquencies remaining low; delinquencies on home equity loans stabilized after an uptick earlier in the year. Commercial lending continued to expand, but at a marginally slower pace than earlier in the year. Most of the slowdown was in commercial real estate loans. Use of existing credit lines picked up, and one contact said that they saw a rise in the number of requests to increase the existing credit lines. One contact noted some slackening in the competitive pressures to ease standards and terms on commercial loans and added that margins had stabilized. Still, there were some concerns that loan pricing was not adequately reflecting risk. Commercial credit quality remained in good shape, on balance.

Prices and Costs
Nonlabor input cost pressures intensified in April and May, while increases in retail prices and wages were similar to the previous reporting period. Almost all contacts reported higher energy costs. The ability to pass these cost increases on to customers varied. Many manufacturers expressed concern about other materials prices, noting gains in the cost of zinc, copper, and carbide. Steel prices increased further since the last reporting period, and one contact said that steelmakers were making up for some of the pricing restraint they had shown at the start of the year. A construction industry analyst noted that uncertainty about material costs has made it more difficult to decide on pricing strategies for projects. Price reports at the consumer level were mixed. Retailers generally reported a competitive pricing environment, though a few noted that they had increased some prices. Hotel room rates were up, while new vehicle prices were flat to slightly lower.

Agriculture
Planting proceeded smoothly in most of the District, though rains delayed activity or forced some replanting, mostly in Indiana. However, southern Iowa still needed more moisture to fully recover from drought. Some farmers switched to planting corn rather than soybeans. At the end of May, the progress of corn and soybean crops was excellent, creating the potential for "record busting yields if the weather cooperates." Plans for additional biofuel plants in the District were announced during the reporting period. Cow and calf ranchers avoided the operating losses seen at cattle feedlots, since calf prices were better than feeder cattle prices.

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Eighth District--St. Louis

Economic activity increased modestly in the Eighth District since our previous report. Both the services and manufacturing sectors expanded. Retail sales were down in April and May compared with a year ago; car sales were down over the same period. Home sales declined in most of the District, while commercial real estate market conditions were mixed. Overall lending activity at a sample of District banks experienced little change in the first quarter of 2006.

Consumer Spending
Contacts reported that retail sales in April and May were down, on average, over year-earlier levels. Approximately 48 percent of the retailers saw increases in sales, while another 48 percent saw decreases. About 39 percent of the retailers surveyed noted that sales levels met their expectations, 48 percent reported sales below expectations, and 13 percent reported sales above expectations. Summer seasonal items, children's clothing, and furniture were all strong sellers, while gift items and higher-end electronics were moving more slowly. Approximately 79 percent of contacts noted that inventories were at desired levels. About 46 percent of contacts expect that summer sales will increase over 2005 levels, and about 33 percent are cautiously optimistic.

Car dealers in the District reported that, compared with last year, sales in April and May were down, on average. About 63 percent of the car dealers surveyed reported a decrease in sales, while 25 percent reported an increase. About 42 percent of the car dealers noted that used car sales had increased relative to new car sales, and 17 percent reported the opposite. One-third reported an increase in low-end vehicle sales relative to high-end vehicle sales, and 13 percent reported the opposite. Nearly 61 percent of the car dealers surveyed reported that their inventories were too high, mostly with new vehicles. About 58 percent of the car dealers surveyed expect sales for the next two months to increase over 2005 levels; about 17 percent of contacts are cautiously optimistic, and about 17 percent expect sales to decrease.

Manufacturing and Other Business Activity
Manufacturing in the Eighth District showed signs of moderate expansion since our previous report. Many manufacturers expressed concern over increasing transportation costs. Contacts in the transportation equipment and furniture industries reported plans to expand operations and hire additional workers. Several small businesses expanded activity. A firm in the auto parts industry reported plans to open a plant in the District next year. In contrast, firms in the household appliance and electrical equipment industries reported plans to close plants in the District by the end of the year. Firms in the fabricated metal product and machinery industries announced plans to lay off workers or relocate outside of the District.

The District's service sector continued to expand steadily in most areas since our previous report. Contacts in the freight transportation, warehousing, and utilities industries reported plans to expand operations in the District. Firms in the rail transportation and business support services industries reported plans to hire additional workers.

Real Estate and Construction
Home sales declined in most of the Eighth District. Compared with the same period in 2005, April year-to-date sales were up 14 percent in Memphis, but fell 6 percent in Little Rock and 1 percent in Louisville and St. Louis. Residential construction continued to slow throughout most of the District. Compared with the same period last year, April year-to-date single-family residential permits declined over 50 percent in Louisville, 13 percent in St. Louis, 4 percent in Memphis, and 1 percent in Little Rock. Permits, however, were up 15 percent in Texarkana, Arkansas, and 22 percent in Jackson, Tennessee.

Commercial real estate market conditions throughout the District were mixed. Compared with the fourth quarter of 2005, the industrial vacancy rate declined in the first quarter of 2006 in St. Louis and Little Rock, but increased in Memphis and in Louisville. During the same period, the office vacancy rate declined in St. Louis and Little Rock, but increased slightly in Memphis and Louisville. Contacts in northeast Arkansas reported that commercial construction activity is very limited, while contacts in northeast Mississippi and south central Arkansas reported that commercial development remains strong.

Banking and Finance
A survey of senior loan officers at a sample of District banks showed little change in overall lending activity in the first quarter of 2006. In this period, credit standards and demand for commercial and industrial loans remained basically unchanged for both large and small firms. During the same period, credit standards for commercial real estate, residential mortgage, and consumer loans remained virtually unchanged. Meanwhile, demand for commercial real estate loans remained virtually unchanged, demand for residential mortgage loans was moderately weaker, and demand for consumer loans ranged from moderately weaker to moderately stronger.

Agriculture and Natural Resources
Planting of the major District crops--corn, soybeans, sorghum, cotton, and rice--is ahead of its 5-year average pace in most areas. Planting of soybeans in Indiana, however, is behind normal pace because of recent rains. Soybean emergence is also behind normal pace in Illinois, Indiana, and Kentucky. The winter wheat harvest has begun in Arkansas and Mississippi. The majority of the District's crops were rated in good condition, although cotton in Arkansas and Missouri was rated mostly in fair or good condition. At least 90 percent of the pastures were rated in at least fair condition in all states except Missouri, where only three-fourths obtained that rating.

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Ninth District--Minneapolis

The Ninth District economy grew at a steady pace since the last report. Increases in activity were noted in consumer spending, manufacturing, tourism, construction, mining, energy, agriculture, and commercial real estate. Meanwhile, residential real estate softened. Since the last report, the pace of employment and wage growth increased slightly. Significant price increases were noted for fuel and some construction materials.

Consumer Spending and Tourism
Overall consumer spending showed solid growth since the last report. A major Minneapolis-based retailer reported same-store sales up about 6 percent in May compared with a year ago. A mall manager in North Dakota said that traffic on Mother's Day weekend was fairly brisk. In contrast, same-store sales at a Minneapolis area mall in April were lower than a year ago.

Car dealers in south-central Montana noted that while consumers are more interested in purchasing four-cylinder cars, sales of trucks and SUVs were still solid. At a Minnesota dealership, May sales were strong, especially for fuel-efficient vehicles.

Spring tourism activity posted modest increases, while tourism officials are cautiously optimistic for the summer season despite higher gas prices. In Duluth, Minn., recent tourism spending was up about 5 percent compared with a year ago, and inquiries for summer activities were strong; business convention spending was about even with a year ago. Tourism businesses in northwestern Minnesota reported a positive outlook for summer activity. Tourism in Montana is expected to grow 2 percent in 2006. According to a tourism official in the Black Hills area of South Dakota, advanced summer bookings started slow but recently reached normal trends.

Construction and Real Estate
Construction was robust. Commercial construction was about level with last year's strong building season in Bismarck, N.D. Developers announced plans for a 1.3-million-square-foot office and commercial development in a Minneapolis suburb. The Minnesota Legislature approved funding for two large stadiums in Minneapolis-St. Paul. Construction began on downtown condos in both Sioux Falls, S.D., and Fargo, N.D. More than $94 million in spending on road and bridge construction and $84 million on state university projects is planned in Montana this summer. However, April year-to-date residential and commercial permits for Rochester, Minn., were down 12 percent in value from last year.

Residential real estate continued to cool. New listings in Minneapolis-St. Paul during the third week of May were up 18 percent over last year, while pending sales were down 21 percent. Inventories in Sioux Falls were up 18 percent from a year ago. In contrast, home sales remained strong in western Montana. The commercial real estate market grew steadily. A bank director reported office, retail, and industrial real estate in Sioux Falls as strong overall but down from last year's record levels. In Minneapolis, commercial office absorption continued to increase; for example, a large company is moving to a 188,000-square-foot office tower downtown. A representative of a commercial real estate firm in Minneapolis-St. Paul noted that businesses that require relatively high volumes of office space were having difficulty finding openings.

Manufacturing
Manufacturing activity expanded. A May survey of purchasing managers by Creighton University (Omaha, Neb.) indicated strong growth of manufacturing activity in the Dakotas and Minnesota. A safety gear manufacturer in Minnesota is expanding into a new plant. Meanwhile, a sewing company in the Upper Peninsula of Michigan reported strong demand and is planning to add space. A commercial bakery in Montana is adding production space, machinery, and equipment.

Energy and Mining
Activity was up slightly in the energy and mining sectors. The number of oil rigs operating in the District increased since the last report. In addition, several new coal-fired power plants, wind farms, and ethanol distilleries are under construction or in the permitting process. One Minneapolis Fed Agriculture Advisory Council member noted that ethanol and biodiesel plants are "springing up like popcorn." Meanwhile, nearly all open mines in the District are producing at near full capacity. Several companies are exploring or permitting new mining sites throughout the District.

Agriculture
Agricultural activity increased slightly since the last report, but prospects for farm income have deteriorated. A good calving and lambing season is mostly complete across the District, with some minor losses reported in areas due to inclement weather. The U.S. Department of Agriculture reported that crop plantings and progress are slightly ahead of last year's pace in most District states. Spring storms aided moisture conditions across most of the District, although central South Dakota is dry. This year's estimated winter wheat yields per acre are up, but production in Montana is down 14 percent from 2005. Responses to the Minneapolis Fed's first-quarter (April) agricultural credit conditions survey indicate that overall agricultural income will be down in the second quarter of 2006 due to higher costs of fertilizer, fuel, and machinery. Meanwhile, the USDA recently estimated that prices of corn, soybeans, and cattle will decrease this year compared with last year.

Employment, Wages, and Prices
Employment grew moderately since the last report. In North Dakota, a wind turbine blade plant will soon add up to 130 jobs, and in South Dakota, a communications company is adding 120 jobs. Two business schools in Minneapolis-St. Paul reported an approximate 20 percent increase in the number of graduates with job offers this year; accounting and finance were among the top areas. North Dakota members of the Minneapolis Fed's Advisory Council on Small Business and Labor noted difficulty finding available labor, particularly low-skilled workers. Preliminary results of the inaugural Minneapolis Fed's May survey of professional services companies indicated increased employment and decreased availability of labor for the next four quarters.

A slight increase in the pace of wage raises was noted since the last report. In the Minneapolis-St. Paul area, wages for many trades, hospitals, and manufacturers were up by about 3 percent to 4 percent. A bank director noted that the starting wage for unskilled workers in Bozeman, Mont., is $6.50, well above the minimum wage. Preliminary results of the professional services survey show an expected average wage increase of about 3 percent during the next four quarters.

Significant price increases were noted in fuel, health insurance, and some construction materials. Gasoline prices in Minnesota were up 79 cents at the end of May compared with a year ago. Freight fuel surcharges have increased to as high as 27 percent of total mileage, according to a Montana bank director. A number of construction materials increased in price, including copper, insulation, steel, and wallboard; in contrast, some lumber prices softened. Preliminary results of the professional services survey reveal that 73 percent of respondents expect overall inflation to increase during the next four quarters.

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Tenth District--Kansas City

The Tenth District economy grew moderately in late April and May. Manufacturing activity expanded strongly, consumer spending increased, and labor markets continued to firm. Commercial real estate activity edged up, and energy activity rose further. On the negative side, residential construction declined modestly, and drought conditions continued to be a problem in the agricultural sector. Wage pressures increased somewhat, while wholesale and retail price pressures were little changed.

Consumer Spending
Consumer spending expanded moderately in late April and May. Most retail contacts reported that sales were higher than in the prior survey period and above year-ago levels. However, some store managers indicated that inventory levels were too high, and they expect to trim inventories going forward. As in the previous survey, retail contacts were generally optimistic about sales in the next several months. Auto dealers reported that sales in late April and May were mostly unchanged from the previous survey period and remained lower than a year ago. Sales of large SUVs and pickup trucks were characterized as weak by many dealers. Inventory levels were said to be satisfactory at most dealerships, and contacts generally expect sales to increase somewhat in the coming months. Travel and tourism contacts reported activity was mostly unchanged since the previous survey. Passenger counts at District airports were generally flat but remained appreciably higher than a year ago. Most hotel contacts said that occupancy rates were similar to those seen this time last year. For the most part, travel and tourism contacts expect solid activity during the summer season.

Manufacturing
Manufacturing activity in the District expanded strongly in late April and May. Production, shipments and new orders increased across the District, and many contacts also reported solid growth in capital spending. Growth in manufacturing activity is expected to remain strong in coming months, but growth in capital spending is expected to slow somewhat. Several contacts noted continued difficulty acquiring steel, but no other materials were reported to be abnormally difficult to obtain.

Real Estate and Construction
Residential construction declined slightly in late April and May, while commercial real estate activity edged up. Home builders reported that starts decreased somewhat since the previous survey, and contacts in most parts of the District expect further declines in the months ahead. Construction materials were generally reported to be available, and no significant problems obtaining materials are anticipated in the coming months. Residential real estate agents in most areas said that home sales decreased slightly since the previous survey, with the high-end market showing the most weakness. Inventories of unsold homes continued to rise in many markets and for the most part were well above year-ago levels. Most contacts expect home sales to hold steady or fall further in the coming months. Home price appreciation remained modest in most areas, and real estate agents expect little growth in home prices going forward. Mortgage lenders reported that demand for home purchase loans was unchanged since the previous survey, while demand for refinancings declined. Some lenders are optimistic about growth in home purchase loans heading forward, but virtually all contacts expect refinancings to continue to decline. Commercial real estate activity improved slightly in late April and May. Vacancy rates declined and rents for commercial space rose slightly from the previous survey period in most markets. Commercial real estate agents expect conditions to continue to improve slightly in the months ahead. Commercial construction remained strong, although there were a few reports that high materials costs were resulting in the scaling down or postponement of some projects.

Banking
Bankers reported that both deposits and loans held steady since the last survey, leaving loan-deposit ratios unchanged. Demand rose slightly for commercial real estate loans and construction loans, while demand for home equity loans fell somewhat. On the deposit side, all types of accounts were stable. Nearly all respondents raised their prime lending rates and consumer lending rates since the last survey. Lending standards were unchanged.

Energy
Energy activity continued to expand in the District during late April and May. The count of active oil and gas drilling rigs in the region increased slightly since the prior survey period and remained well above year-ago levels. Many contacts continued to report that shortages of equipment and labor were constraining drilling activity. Drilling is expected to expand further in the months ahead. Mining activity also remains strong in the District, and a recently announced railway expansion is expected to ease delays in the transport of coal from Wyoming's Powder River Basin.

Agriculture
Agricultural conditions in the District deteriorated in late April and May as drought conditions intensified. In some areas, winter wheat production is expected to be roughly 50 percent below last year's level. Because of the expected poor crop, wheat prices are the highest they have been in several years. Cattle producers have also been adversely affected by the extended drought, as deteriorating pasture conditions continued to force early placements of cattle into feedlots. Respondents expressed concerns about high fuel and fertilizer costs, as well as the increasing cost of rail transportation.

Labor Markets and Wages
Labor markets continued to firm in late April and May, and wage pressures increased somewhat. Hiring announcements once again outpaced layoff announcements by a sizeable margin. Many of the new jobs announced were in the manufacturing sector. In addition, the job market outlook for recent college graduates across the District was reported to be very favorable. The percentage of contacts reporting labor shortages was similar to the previous survey, but the fraction of firms reporting above-normal wage increases rose somewhat. Among the workers reported to be in short supply were engineers, auto technicians, nurses, oil and gas workers, and skilled manufacturing workers.

Prices
Wholesale and retail price pressures generally held steady in late April and May. A slightly higher percentage of manufacturers than in the previous survey reported higher prices for raw materials, including steel and petroleum-based inputs. However, the share of firms reporting higher finished goods prices was little changed and substantially below the share reporting higher materials prices. Also, expectations for future increases in raw materials and finished good prices were about the same as in the previous survey period. Home builders indicated that materials costs were mostly stable, but some builders expect price increases in the months ahead. Both the share of retailers reporting higher prices than a year ago and the share planning price increases in the next several months held steady.

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Eleventh District--Dallas

Eleventh District economic activity continued to expand quite strongly from mid-April to early June. Energy activity is still very robust, and both the manufacturing and service sectors report continued strong activity. Construction and real estate activity remained brisk, but there was a noticeable dip in the market for lower priced homes, particularly in Dallas and Fort Worth. Retail sales growth weakened slightly. Financial service contacts continue to report favorable conditions. Spring rains have improved agricultural conditions, but parts of the District remain very dry, and drought has damaged some production. Rising costs pushed up selling prices for many industries.

Prices
Prices are higher for a number of inputs, including crude oil, fuel, chemicals, paper, packaging, metals and transportation. Some retailers and most manufacturers said they had passed cost increases through to higher selling prices. Service sector firms also report they are charging higher prices. There were a few reports of price declines, most notably for natural gas.

Prices are higher for most construction-related manufactured products, but prices fell for a few products used in homebuilding. Builders say rising construction costs are a growing concern because stiff competition is making it difficult to increase prices.

Crude oil prices hovered around $70 per barrel during the period boosted by concerns that political tension and terrorism could lead to supply disruptions. The recovery of refinery capacity along the Gulf Coast helped push oil demand back up to normal ranges, but consumption remains on the low side of the 5-year average, and inventories of crude are well above historical levels.

Gasoline prices in the District increased at the pump throughout most of the period, rising to near $3 per gallon in mid-May. Inventories of reformulated gas fell to very low levels as the industry changed to ethanol-based oxygenates. The change appears to be nearly complete, but ethanol is in short supply and a series of refinery outages has kept markets nervous.

Mild weather reduced demand for natural gas, and inventories increased to 55 percent above normal for this time of year. Prices fell from $8 to $6 per million Btu at Henry Hub. Prices would have fallen further if not for rising crude prices and the coming hurricane season.

Prices are higher for most chemicals. After falling through March and April, major plant outages pushed up ethylene prices in May. Higher ethylene prices, low inventories and a boost in demand pushed up polyethylene prices. Propylene, which can be used the production of gasoline, rose along with prices at the pump. Polypropylene prices were also up. Polyvinyl chloride prices were lower, which contacts attributed to weaker sales to homebuilders.

Labor Market
The labor market continues to tighten, with reports of increased hiring in manufacturing and services. Firms are reporting more difficulty finding workers, and more contacts say that it is necessary to increase wages to obtain or retain employees. Shortages are mostly for skilled positions, such as for truckers, lawyers, accountants, financial analysts, high tech engineers and workers to supply the energy industry--especially welders and engineers. Temporary service firms say it is harder to find qualified workers, particularly since their customers are resisting wage increases. There has been an increase in the number of direct hires and temp-to-perm hires, which they say reflects the confidence their clients have in the growth of the economy.

Manufacturing
Manufacturing activity remains strong. Demand continued to be robust for most construction-related products, including metals, cement, stone, clay, brick and glass. The majority of producers said demand was still strong from residential homebuilders, but producers of lumber noted some weakening. Still demand remains heavy to supply lumber to commercial builders.

The paper industry reported stronger demand for products, particularly to supply schools and hospitals. Sales of food and apparel products were unchanged. The high-tech industry reported continued good growth. Semiconductor producers said demand was up, and one firm reports that their bookings are stronger than revenue. Most respondents said inventories are at desired levels, and prices are firming.

Refinery capacity utilization along the Gulf Coast returned to 90 percent for the first time since the hurricanes, primarily due to the return of three large refineries (two in New Orleans and one in Houston). The return from spring maintenance continued to be slower than expected. The chemical industry also continues to recover from the hurricanes. Contacts say demand for plastics is probably being helped by some precautionary inventory building before the hurricane season.

Services
Temporary staffing firms report steady activity, up significantly from a year ago. Law firms say demand for their services has been steady, and accounting firms say activity levels are typical for this time of year. The transportation industry continued to report strong demand. Rail volume has been very strong, boosted by shipments of coal, coke and metals. Activity in the trucking and airline industries also remains strong.

Retail Sales
Overall retail sales growth weakened slightly since the last Beige Book. Reports from retailers were very mixed, with some reporting very good or extraordinarily strong sales, while others reporting that sales were soft or disappointing. Sales continue to be weakest at stores selling to lower-income customers, who are spending a larger share of their disposable income on gasoline and energy utilities. Consumers appeared to be changing their buying habits to accommodate rising prices and higher gasoline costs. Retailers say customers are making less frequent visits to the store and switching to stores that are closer to home. Auto sales increased seasonally in most markets, although sales in Dallas were unchanged. Some dealers report sizable excess inventory because demand was less than anticipated during the winter months. Contacts expect the recent increase in rebates and other incentives to boost sales.

Construction and Real Estate
The housing market softened slightly following very strong growth over the past year. Sales of existing homes are still brisk in Austin, El Paso, Houston and San Antonio, but sales weakened in Dallas and Fort Worth. Demand for lower priced homes has dipped noticeably in several markets, which contacts attribute to higher interest rates, rising energy costs and tighter lending standards. Overall, industry leaders say residential real estate activity is solid at very high levels, but they are quite nervous about the market being affected by press reports of a possible fall off in housing prices.

Demand for apartments remains strong, and occupancies are increasing in most markets, but rents are not firming as expected. A notable exception is in Houston where hurricane evacuees continue to stimulate the market, particularly for Class B and C properties. There is growing concern about overbuilding of condominiums and town homes in Dallas, and contacts fear that it will end badly. Demand for office space continues to edge up at a steady pace, with rents firming. Contacts say retail markets remain healthy. Demand for industrial properties is gradually improving.

Financial Services
Commercial loan demand remains steady, according to lenders who say there continues to be competitive pressures on pricing. Commercial lenders are very optimistic about the future and say loan quality is still very good. Respondents lending to consumers say borrowing remains steady, and credit quality is good.

Energy
The Texas rig count continues to rise rapidly, with most of the drilling on land and directed toward natural gas. Two rigs were added in the Gulf of Mexico over the past month, but rigs continue to leave the Gulf because drilling in other locations is more profitable and the approaching hurricane season has pushed up insurance premiums.

Recent weakness in natural gas prices has not curtailed exploration according to contacts. Some drilling for natural gas could become unprofitable if current prices persist or weaken further, but the futures market shows stronger prices by late fall. The current surplus of natural gas in storage could disappear quickly with a hot summer or a hurricane-related disruption of supply.

The industry's expansion is still being constrained, mostly by shortages of labor. Strong demand and rising prices for inputs, including commodities and labor, are pushing up prices of oilfield services.

Agriculture
Spring rains have improved planting, range and pasture conditions in some parts of the District. Other areas remain very dry, however, and herd reduction continues. Drought damaged the winter wheat crop, and production was down 65 percent from last year. Cotton and grain sorghum crops in South Texas have also been damaged, and producers are collecting insurance on these crops.

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Twelfth District--San Francisco

The Twelfth District economy expanded at a solid pace from mid-April through the beginning of June, with slight moderation evident in some sectors. Wage and price inflation reportedly were modest on net, although wage growth remained rapid for selected worker groups with specialized skills. Retail sales expanded somewhat and demand for services was strong. Demand for District manufactured products grew overall but fell for some construction materials. Producers of agricultural and resource-related products saw solid demand. Residential construction, sales activity, and price appreciation softened further, while demand for commercial real estate continued to expand. District banks reported strong loan demand on net but further easing in mortgage demand; credit quality remained very high.

Wages and Prices
Contacts reported little or no change from the modest upward pressure on prices noted in the previous survey period. Significant increases in final prices were largely confined to products and services for which energy costs are a significant component, such as construction and transportation services. More generally, contacts reported that vigorous competition and ongoing productivity gains sharply limited their ability to pass rising input costs on to final prices, although they provided scattered reports of increased pricing power for some retail items.

District labor markets tightened a bit further during the survey period. Upward wage pressures were moderate overall, but wage increases remained rapid for workers with specialized skills in the construction, health-care, information technology, and financial services sectors. More generally, contacts reported healthy hiring activity, although the pace of hiring has slowed in parts of California.

Retail Trade and Services
Retail sales grew modestly during the survey period. Demand for domestic automobiles reportedly improved in recent weeks, although sales remained below year-earlier levels as high gas prices held down demand for large SUVs and light trucks. By contrast, sales of selected fuel-efficient imported vehicles reportedly remained at record highs. Sales of apparel and other small retail items expanded, although performance varied substantially across retailers.

Most service providers saw robust demand. Activity was brisk in the health-care services, professional services, and transportation sectors. Sales and hiring activity grew further for providers of technology services, although the employment outlook in this sector was clouded slightly by a report of reduced use of temporary employees. District travel and tourist activity was vigorous. In Hawaii, substantial increases in domestic tourist arrivals and spending offset recent declines in Japanese tourist activity relative to year-earlier levels. For major District tourist destinations in general, hotel occupancy rates remained high and room rates rose further.

Manufacturing
Demand for District manufactured products grew further on net. Orders and sales of semiconductors continued to expand, and capacity utilization generally hovered at or above 90 percent. Orders for commercial aircraft grew further and production continued at a rapid pace in the Pacific Northwest, keeping aircraft manufacturing establishments and their subcontractors operating near full capacity. Demand for processed food grew further and demand for apparel picked up, with balanced inventories reported in both sectors. In contrast, demand declined and prices fell slightly for building supplies commonly used for residential construction purposes, most notably wood products.

Agriculture and Resource-related Industries
Demand for District agricultural and resource-related products was strong during the survey period of mid-April through the beginning of June. Sales remained robust for most crops and livestock; inventories were balanced in general and prices were stable to down slightly, despite supply constraints imposed by continued drought conditions in Arizona and earlier excess moisture in California. Contacts reported that the cost of fuel and fertilizers increased further from high levels, although the rate of increase abated. In the resources sector, producers of oil and natural gas saw robust demand and operated at close to full capacity, although one contact noted that inventories of natural gas are very high, putting downward pressure on prices.

Real Estate and Construction
Activity in residential real estate markets continued to decelerate, while demand for commercial real estate picked up further. The pace of sales and price appreciation, along with other indicators such as time on the market, point to significant cooling in residential real estate markets in most areas; the exceptions are Utah and parts of the Pacific Northwest, where housing markets reportedly remain hot. On the commercial side, office and retail vacancy rates fell and rental rates rose further in most major markets. Overall construction activity was at high levels, with rising activity for commercial and public structures offsetting declines for residential construction projects in some areas. Contacts reported that some builders continued to face cost increases and minor project delays as a result of tight availability of skilled workers and selected materials such as steel and cement.

Financial Institutions
District banking contacts reported robust demand in most loan categories, with the exception of declining demand for residential mortgages. Commercial and industrial lending continued to grow steadily, and asset quality remained excellent. Originations for new residential mortgages fell, but contacts reported that home refinancing activity was brisk in some areas, as borrowers switched from variable to fixed terms in the face of rising interest rates.

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