The Federal Reserve Board

June 13, 2007

Summary of Commentary on Current Economic Conditions by Federal Reserve District

Summary

Prepared at the Federal Reserve Bank of Philadelphia based on information collected before June 4, 2007. This document summarizes comments received from businesses and other contacts outside the Federal Reserve and is not a representation of the views of Federal Reserve officials.

Reports from the twelve Federal Reserve Banks indicated that economic activity continued to expand from mid-April through May. Seven banks described growth in their Districts as modest or moderate: Cleveland, Atlanta, Chicago, St. Louis, Kansas City, New York, and San Francisco. Dallas reported growth as moderately strong, and Minneapolis said the District's economy edged up. Philadelphia reported that growth was somewhat faster than in recent months, and Richmond said growth picked up a bit. Boston characterized reports from its contacts as generally positive.

Consumer spending and retail sales were generally up in late April and May, with a number of Districts reporting that luxury items were selling better than lower-end merchandise. On net, there was little change in auto sales across the Districts, and dealers are about evenly split on whether there will be any pickup in sales over the summer. Travel and tourism remained healthy despite the recent rise in gas prices, although the rise in prices remains a concern for the summer. Except for trucking, reports from the service industries were generally positive. Declines were widely reported in the trucking industry, however. Manufacturing activity was up in a majority of Districts. There was weakness among manufacturers producing for the residential construction industry but strength among machinery and equipment manufacturers in several Districts.

There was continuing weakness in residential real estate and construction but increasing strength in the commercial real estate sector, including both office and industrial space. Half the District banks reported little or no change in overall loan demand, with strength in commercial lending and weakness in residential mortgages and consumer lending. In the agricultural sector, crop conditions improved and were generally described as good. An early spring frost harmed some winter wheat, and drought conditions caused problems in the Southeast and the far West. Oil and gas exploration increased in recent months, but coal production was down.

Hiring activity picked up in late April through May, especially for workers with specialized skills. But most Districts reported that overall wage pressures do not seem to have increased. There have been significant price increases for energy-related products and several raw materials, but the prices of some raw materials have remained stable.

Consumer Spending and Tourism

Consumer spending and retail sales were up in late April and May, but changes in consumer spending varied by category and by District. San Francisco reported moderate growth in sales, and Chicago reported a gradual increase in consumer spending. The majority of retail contacts in St. Louis said sales met or exceeded expectations. New York noted that retail sales were close to plan, with business particularly brisk in New York City. However, contacts in four Districts--Cleveland, Atlanta, Kansas City, and Dallas--noted that sales were disappointing or below expectations. Atlanta and Minneapolis described sales growth as marginal or modest. According to contacts in Philadelphia, Chicago, and San Francisco, luxury items were selling better than low-priced items. Several District banks reported weakness in sales of big ticket items such as furniture and household durables. Mall traffic was down in Philadelphia, Richmond, Minneapolis, and Kansas City. Reports from Cleveland, Richmond, Dallas, and San Francisco suggest that higher gasoline prices may have restrained consumer spending on other items. Retailers in Boston, New York, Chicago, and St. Louis generally reported inventories at expected or desired levels. Philadelphia reported no major change in inventories, while Atlanta and Kansas City reported that inventories had risen. Looking forward, a majority of retailers in St. Louis see year-over-year sales increases this summer, and Philadelphia retailers see sales growth continuing at the current rate. But in Cleveland and Kansas City retailers anticipate slower or modest sales growth in the immediate future.

Auto sales were steady or little changed in five Districts: Cleveland, Chicago, Minneapolis, Dallas, and San Francisco. They picked up in the last few months in Philadelphia from low levels earlier in the year, and they were above last year's level in St. Louis. Auto sales were down, however, in Atlanta and Kansas City. Dealers in St. Louis and Kansas City remain optimistic about a pickup in sales, but dealers in Philadelphia and Cleveland do not expect much change.

Spending on travel and tourism remained healthy despite the recent rise in gas prices. Spending by tourists was strong in Boston, New York, Richmond, Minneapolis, Kansas City, and much of the San Francisco District. Reports from Boston, New York, and Kansas City mentioned higher rental rates for hotel rooms. Tourism was down, however, in Hawaii and in Michigan. Contacts in several Districts expressed concern that higher gas prices may negatively affect travel and tourism this summer.

Services

With the exception of trucking, growth in the service industries generally has been positive. Information technology services experienced double-digit growth year over year in the Boston area. Both Dallas and San Francisco reported solid demand for IT services. Minneapolis mentioned growth in professional services generally, and Dallas reported strong demand for corporate legal services and accounting.

In the trucking and shipping industry, sluggish demand or declines were noted in half the Districts: Cleveland, Richmond, Atlanta, Chicago, St. Louis, and San Francisco. Dallas was the only District to mention a pickup in the trucking business.

Manufacturing

Most Districts reported that manufacturing activity was up in the most recent period. Growth rates varied by industry group, however, and some Districts experienced little or no overall growth. Cleveland and Chicago reported stable conditions or little change in the manufacturing sector. St. Louis said manufacturing activity was mixed. Richmond is the only District that reported a decline in manufacturing activity. Some Districts (Philadelphia, Atlanta, Dallas, and San Francisco) mentioned that industries producing for the residential construction market were weak. On the other hand, four Districts--Boston, Philadelphia, Cleveland, and Chicago--mentioned that there was strength among machinery and equipment manufacturers. While several Districts mentioned capital spending plans, reports on capital spending from Philadelphia, Cleveland, and Kansas City were particularly positive. Both New York and Philadelphia noted that manufacturers were optimistic about growth over the remainder of this year. Manufacturers in Boston and Cleveland expected little change in activity.

Real Estate and Construction

The real estate and construction industries were marked by continued weakness in the residential sector and increasing strength in the commercial sector. Most Districts characterized their housing markets as soft or weak. San Francisco reported that sales volumes for both new and existing homes fell further in most areas, with modest price declines in some parts of the District. Minneapolis described the District's housing markets as mostly weak, and Dallas described the District's housing markets as soft, noting high cancellation rates for new home sales in Dallas and continued slowing in the Houston market. Philadelphia reported no improvement in the housing market, and Cleveland reported that new home sales were stable but prices were down. Atlanta reported that sales have stabilized at low levels in parts of Florida but continued to decline in Georgia. Reports from Richmond and St. Louis were mixed, with sales stabilizing or improving in some areas but declining in others. The most positive report on housing markets came from the New York District where there were signs of strengthening in New York City, parts of Long Island, and some close in New Jersey suburbs. However, housing markets in the rest of the New York District remain sluggish. No District reported an increase in new home construction. Moreover, inventories and days on the market continue to rise in some Districts, although the Kansas City District has seen a reduction in inventories. Realtors in the Philadelphia, Cleveland, and Atlanta Districts anticipate that the weakness in the housing market will last several more months at least.

There was widespread improvement in commercial real estate markets in recent months. More than half the Districts reported that leasing activity was picking up in most of their major markets and vacancy rates were falling. Boston, New York, Philadelphia, and San Francisco also mentioned increases in office rents. Four Districts (Philadelphia, Richmond, Minneapolis, and Dallas) reported strong demand for industrial space, especially warehouse space. Chicago, on the other hand, reported that industrial development was sluggish. All the Districts that mentioned commercial construction activity gave positive reports.

Banking and Finance

Half the Districts reported little or no change in overall loan demand: New York, Cleveland, Atlanta, Chicago, St. Louis, and Dallas. Philadelphia noted that loans were increasing at a steady pace, and San Francisco reported further growth in loan demand. There was more strength in commercial lending than in consumer lending. About half the Districts noted increases in commercial lending, and growth in commercial lending was reported to be solid or strong in Philadelphia, Richmond, and Dallas. Kansas City, on the other hand, experienced an easing of C&I loans except for commercial real estate. Consumer lending increased at a steady pace in Philadelphia, and lending for autos and marine equipment was up in Cleveland. But Dallas saw a decline in lending for autos.

Residential mortgage lending was either declining or flat in all the Districts reporting except New York, where there was a pickup in mortgage lending. New York, Atlanta, and Chicago mentioned higher mortgage delinquencies. In Philadelphia and Cleveland lenders have little or no expectation of a pickup in mortgage lending through the rest of this year. Credit standards are mostly unchanged, except for home mortgages in New York and commercial real estate in St. Louis.

Agriculture and Natural Resources

In most Districts crop conditions were described as good or improving. But Chicago reported that crop conditions were mixed, ranging from "stunted" to "excellent." A spring frost in parts of Mississippi, Tennessee, Kentucky, and Kansas caused damage to the winter wheat crop. Drought conditions in the Southeast and in parts of the San Francisco District hindered crop development and harmed pasture land. In the San Francisco District some cattle were brought to market early because of the lack of adequate grazing land. A number of Districts noted higher prices for corn, soybeans, and wheat. The higher cost of feed grains has resulted in higher prices for cattle and hogs.

Exploration and development of oil and gas increased in the Atlanta and Minneapolis Districts. The rig count was up modestly in the Kansas City District, and the number of rigs is expected to continue to increase. Rig counts have remained stable in Texas, but they are at relatively high levels. Older rigs, however, are being refurbished. Oil and gas development was described as high in Cleveland and production as flat to slightly up. But coal production is down in the Cleveland District. Minneapolis reported that mining production was flat but the industry was producing at near capacity.

Labor Markets, Wages, and Prices

Several District reports mentioned that hiring activity increased in the late April through May time period. Staffing agencies in Boston and New York noted that demand was high for workers in information technology, medical, and financial service industries. Several Districts mentioned that the market for workers with specialized skills was tight. On the other hand, layoffs continued among home builders and in the manufacturing and service industries associated with home building. Wage increases were variously described as modest (Atlanta), steady (Philadelphia), or moderate (Minneapolis and San Francisco). Kansas City reported that while wages were up, wage pressures had eased since the previous report.

More than half the Districts mentioned higher energy prices for both producers and consumers. Several Districts (Cleveland, Minneapolis, Kansas City, and Dallas) reported rising prices for several raw materials, such as copper. Atlanta and Richmond reported, however, that prices for raw materials were steady or even down. There were differing reports on the costs of construction materials. Kansas City reported that construction costs were mixed. Atlanta said the cost of construction materials was lower, and Dallas said the cost of building materials was moving up. At the consumer level both Kansas City and Dallas mentioned the rising cost of food. However, District reports generally did not indicate an increase in overall price pressures. For example, Chicago noted that price pressures were similar to the last report, and San Francisco observed that overall price inflation seemed to be modest.

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First District--Boston

Business contacts in the First District gave generally positive reports when contacted in late May, with the exception of retail and tourism. Retailers' results are mixed; but other contacted sectors cite continuing solid gains in revenues or sales. While most costs and selling prices are said to be relatively stable, many retail and tourism respondents express concern about high transportation costs, both for freight and as a possible drain on other consumer purchases.

Retail and Tourism

Retail respondents in the First District report mixed sales results for the months of April and May. Same-store sales ranged from low double-digit decreases to middle single-digit increases year-over-year.

A lumber company reports that sales are down almost 15 percent year-to-date, although same-store sales were up sharply in May. The contact is hopeful that the recent uptick in sales is a sign that business is finally starting to rebound. A surplus and salvage store reports that business is "absolutely terrible," with same-store sales down 10 percent from last year. The respondent notes that sales of furniture and flooring, as well as big ticket items, are weak, although food sales continue to do well. By contrast, a drugstore chain reports that same-store sales are up more than 6 percent year-to-date; nonetheless, this represents a slight slowdown from its previous pace. A respondent in the clothing and sporting goods business indicates that although sales have been mixed over the last few months, same-store sales are still up more than 5 percent year-to-date. The contact comments that despite increasing fuel costs, "you can't divorce people from their spending habits."

Inventory levels are mixed, but mostly in line with expectations. All respondents express concern over the rising cost of fuel, with several reporting large increases in transportation and freight costs. Some retailers are passing along small price increases to their customers. Employment has been mostly steady, while capital spending plans are mixed. One contact reports the largest capital spending year in the company's history; another says capital spending plans are on hold while sales remain weak. Overall, retail respondents are cautious in their outlook.

A tourism contact reports that business, convention, and leisure travel were all strong for the months of April and May. In the Boston metropolitan area, revenue per available room is reported to be up 7.8 percent, the average room rate up 4.6 percent, and occupancy rates are up about 1 percent compared to year-ago levels. Hiring is increasing, and several major new hotels are slated to open in the next year. Looking forward, gas prices are a concern, especially for leisure travel.

Manufacturing and Related Services

Manufacturers and related services providers headquartered in the First District generally report that sales and orders continue to run higher than a year ago. Most machinery and equipment manufacturing contacts indicate that, to date, their 2007 revenues are up at double-digit rates from a year ago. They are experiencing particularly strong growth in demand for transportation equipment and alternative energy generation equipment, as well as from various export markets. Domestic demand for residential HVAC equipment continues to slump.

Manufacturers generally indicate that their materials and energy costs are stable overall, although some express concern that metals costs remain either high or volatile. In addition, a food manufacturer is facing rising costs for grain and a paper goods manufacturer has stocked up on paper in anticipation of higher costs by year end. Most contacts say their selling prices are holding stable or decreasing in line with prior trends. However, a couple of firms in strong niches report that they are able to increase their prices with little pushback on the part of customers.

Manufacturers and related services providers mostly expect their U.S. headcounts to remain fairly steady or edge down in 2007. Average wage and salary increases remain in the range of 3 percent to 4 percent. For the most part, contacts continue to report that labor markets for skilled workers are tight, and about one-quarter of respondents indicate that turnover rates have worsened or that labor market competition has heated up recently. Domestic capital spending plans vary widely, depending on factors such as sales trends, IT implementation cycles, and decisions concerning whether to upgrade manufacturing facilities or rely more on outsourcing and offshoring.

Manufacturers mention a range of positive and negative forces operating on their business and the general economy. For the most part, however, their outlook for the coming six to twelve months remains little changed from earlier this year.

Software and Information Technology Services

The majority of software and IT services contacts in the First District report double-digit year-over-year revenue increases. Most responding New England software companies have left selling prices unchanged as a result of a competitive market environment. Headcounts are increasing, generally modestly, with selective hiring of technology workers. All contacted firms have raised pay, generally between 3 percent and 5 percent. Approximately half of respondents indicate that they have increased capital and technology spending relative to last year in order to expand or upgrade equipment; the remaining contacts are holding capital and technology expenditures stable.

New England software and IT services firms are generally positive in their outlook. With strong orders in the pipeline, revenues and profits are generally projected to continue growing at current rates.

Staffing Services

Staffing respondents in the New England region are extremely upbeat this quarter. Business is "very solid" for some firms, and picking up significantly for others. Demand for staffing services is growing in the medical, software and IT, biopharmaceutical, academic, and finance industries. Contacts also indicate that demand for direct-hire services continues to increase. While they are struggling to find enough skilled applicants to fill open positions, staffing respondents are not as concerned about the problem as they were a year ago. Both bill rates and pay rates are steady or increasing, with several contacts noting that the increases have been significant.

Staffing respondents are concerned about potential cost increases associated with the implementation of new healthcare laws in Massachusetts and Vermont, but remain uncertain about how the laws will affect their businesses when they go into effect in July. Despite these questions, however, contacts are optimistic about the near future, expecting solid growth to continue through the end of the year.

Commercial Real Estate

Commercial real estate markets in New England remain solid. Vacancy rates have been steady or declining, and contacts report stable or slightly higher rents. The Boston office market is reportedly strong, with vacancy rates at or below 10 percent downtown and in the mid-teens in the suburbs, and small positive absorption of office space in the first quarter. High-quality space is filling up quickly and inventory is declining. Rents continue to rise inside Route 128, but remain soft "for now" in the outer suburbs.

In Hartford, the suburban market is strong. In Portland, suburban vacancy rates remained constant over the past year, while they decreased moderately downtown. Similarly, the suburban Providence office market is relatively weak, while downtown Providence lacks inventory of Class A office space. New construction is limited throughout the region, in part due to high costs of construction.

Although rental market conditions are good, contacts continue to be surprised by the extremely strong demand for commercial properties, especially by foreign investors. Office properties tend to receive multiple offers and sell above their asking prices, and according to some respondents, above what underlying market conditions would warrant with typical capitalization rates. Looking forward, contacts expect office rental markets to remain stable throughout the region, with somewhat diminishing vacancy rates over the next quarter.

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Second District--New York

Economic activity in the Second District continued to expand at a moderate pace since the last report. The labor market showed further signs of tightening, particularly for experienced office workers. Retailers indicate that sales were generally on or close to plan in May and that selling prices remained steady. Tourism activity remained high, though revenues have leveled off somewhat since the last report. Consumer confidence in the region slipped in May but remained at a high level.

Manufacturers report that activity picked up moderately in May, and that increases in both prices paid and prices received were about as prevalent as in April. Housing markets were mixed but generally firmer than in the last report, led by increased strength in and around New York City. Office markets in the New York City area were steady in April and May. Finally, bankers report increased demand for business mortgages, but sluggish demand for consumer loans; they also note continued tightening in credit standards, and an increase in delinquency rates on home mortgage loans.

Consumer Spending

Retailers report that sales were generally close to plan in April and May, with same-store sales running 2 to 5 percent ahead of a year earlier. Business was reported to be particularly brisk at New York City stores. Contacts note continued sluggishness in sales of home durables but indicate ongoing strength in apparel sales. Inventory levels are generally characterized as satisfactory, with one contact describing inventories as somewhat lean. Retailers indicate that selling prices remain stable.

The Conference Board's latest survey of Middle Atlantic residents showed confidence retreating in May, after climbing to a cyclical high in April. Tourism activity in New York City remained strong in April and May, though growth has leveled off since the last report, possibly due to capacity constraints. Hotels continued to run at close to full capacity, while room rates were up nearly 15 percent from comparable 2006 levels. Broadway theaters report that both attendance and revenues have held steady at high levels in recent weeks, and were up only modestly from a year ago.

Construction and Real Estate

Commercial real estate markets were mixed in April and May. Manhattan's office rental market remained exceptionally tight in May, despite some slowing in leasing activity: vacancy rates in Midtown and Downtown Manhattan were little-changed near cyclical lows, while asking rents continued to climb, rising close to 30 percent ahead of 2006 levels. Conversely, suburban markets are described as somewhat slack--reflecting higher vacancy rates and only modestly rising rents--though there has reportedly been some recent pickup in leasing activity, attributed to tenants seeking cheaper back-office space. The commercial property sales market has been brisk in and around New York City, marked by high volume and substantial appreciation in prices--particularly in Manhattan and Long Island. In contrast, property sales and prices have generally been flat in the Albany, Rochester and Buffalo areas.

Housing markets have shown some signs of strengthening since the last report, particularly in New York City and parts of Long Island. After a brisk first quarter, Manhattan's co-op and condo market showed further signs of strengthening in April and May, according to both a major broker and a major appraisal firm. Prices have accelerated, sales activity has remained brisk and the number of listings (inventory) has continued to retreat, especially at the high end of the market. Manhattan's rental market is reported to be increasingly tight as well. The market for co-ops and condos on New Jersey's "Gold Coast"--across the river from Manhattan--and the market for vacation homes on Long Island are both also described as strong. However, housing markets in the rest of the District have largely remained sluggish: New Jersey homebuilders report that the market has stabilized at low levels, while New York State Realtors report that the housing market slowed in April.

Other Business Activity

A major New York City employment agency reports that hiring activity remained strong in May but that it has become increasingly difficult to fill jobs. This contact also notes that companies are very reluctant to give up seasoned employees and are frequently making counter-offers. Hiring has been particularly brisk in the financial sector, with strong demand from major Wall Street firms, medium-sized banks, and hedge funds. One contact also notes a recent pickup in hiring at commercial real estate firms. However, demand for workers in the publishing, advertising and consumer products industries is described as still sluggish. Starting salaries for college graduates are reported to be little changed from a year ago, but salaries for experienced workers have reportedly escalated.

New York State manufacturers report some pickup in growth in May, and express increasingly widespread optimism about the six month outlook. Firms also indicate steady increases in both prices paid and received. Regional purchasing managers report mixed but generally favorable conditions: Rochester-area purchasers indicate some deceleration in activity in May, while Buffalo-area purchasers note a quickening pace of growth. Incoming volume at the Port of New York and New Jersey is reported to have slowed somewhat in recent months, though shipping schedules for upcoming months suggest a brisker than usual pickup in July and August, when holiday merchandise typically arrives.

Financial Developments

Small to medium-sized banks in the District report little change in overall loan demand. In the residential mortgage segment, however, loan demand picked up, with more bankers reporting increases than decreases in demand for the first time in almost two years. Demand remained unchanged for commercial mortgages and industrial loans. Respondents reported declines in refinancing activity, though to a lesser degree than in recent surveys.

Bankers reported tightened credit standards, particularly on home mortgages. Respondents report that loan rates increased in the residential mortgage category but were unchanged in the other categories. Finally, more bankers report rising than declining delinquency rates on residential mortgages; however, little or no change in delinquencies is indicated in other loan categories.

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Third District--Philadelphia

The Third District experienced improved economic conditions in May, and the pace of growth was somewhat faster than in recent months. Manufacturers, on balance, reported increases in shipments and new orders, although activity among manufacturers dependent on the residential construction industry was slower. Retailers experienced different conditions depending on the market segment they serve. Sales of high-end goods increased significantly, while sales of other merchandise remained flat or increased only slightly. Auto sales have increased over the past few months, but they remain below averages in recent years. Bank lending rose at a moderate pace, with commercial and industrial lending showing the most strength. Activity in the commercial real estate sector has been relatively strong, but there has been no pickup in the residential sector. Firms commenting on labor costs generally reported steadily increasing wages, but there has been more cost pressure from nonwage benefits. Firms also reported significant price increases for raw materials and energy.

Third District firms generally see business activity expanding in the second half of 2007. Manufacturers plan increased capital spending and expect more demand for their products in the months ahead. Retailers expect sales to continue to increase at their current rate. Auto dealers do not expect much change in the pace of car sales. Bankers anticipate a continuation of the steady increase in loan volume.

Manufacturing

Third District manufacturers reported increases in shipments and new orders in May. The increases were moderate, but they were the highest net increases since the beginning of the year. About one-third of the manufacturers contacted reported that current demand is greater than what they had expected at the beginning of the year, and only about one-quarter reported that demand is lower than what they had expected. Also, considerably more firms have increased their capital spending plans since the beginning of the year than have decreased them. Firms producing capital goods, such as electrical machinery and industrial equipment, generally reported increased activity in May, and they expect stronger activity over the next six months. On the other hand, those manufacturing firms whose business is related to residential construction reported slower activity.

Over 40 percent of the manufacturing firms contacted for this report expect an increase in new orders, shipments, and overall activity in the second half of the year, and about a third expect activity to remain at its current level. Very few expect a decline in activity. Overall, manufacturers were more positive in this report than they were in their last report.

Retail

Retailers in the Third District reported varying rates of growth depending on the segment of the market they serve. Sellers of luxury items, excluding jewelry, enjoyed double-digit growth on a year-over-year basis, while the growth rate for most other items was significantly slower. Low-end merchants experienced little to no growth. Malls reported less traffic but higher average purchases. Most store executives reported no major changes to their inventories, and they expect sales growth to continue at around the current rate.

Contacts report that overall auto sales have picked up somewhat in the last few months relative to the slow pace of January and February. Sales are still at relatively low levels, however. In general, dealers do not expect any significant pickup in sales in the near term, and they believe the recent trend of dealer closings and consolidations will continue through the rest of the year.

Finance

Outstanding loan volumes increased at a steady pace in May, according to bankers in the Third District. Commercial and industrial lending remains strong, and 2007 is expected to be an above-average year for commercial lending. Buyout activity was cited by several lenders as an important reason for the increased borrowing by businesses, but borrowing for capital expenditures also contributed to the strength.

Consumer lending has remained steady. Credit card delinquencies are stable, and payment rates on consumer credit are holding up. Residential lending is flat or down from last year. However, there is some regional variation; contacts report that residential lending in the Philadelphia suburbs is up relative to the same period last year. Overall, mortgage delinquency rates are holding steady. Some firms do not expect a pickup in residential lending to begin until sometime in 2008.

Real Estate and Construction

Commercial real estate firms report that office vacancy rates in the region have declined significantly over the past several months, and in response, landlords have asked for higher rental rates. The amount of leased space has increased in most markets in the region, and commercial real estate contacts expect this trend to continue. Construction is up across the region, although contacts caution that stricter scrutiny by rating agencies may have a dampening effect on future investment.

Industrial real estate firms report that overall demand for industrial space remains strong. Vacancy rates are near record lows in some markets, and rental rates continue to rise, particularly for warehouse space, for which rents are at all-time highs.

In contrast to the improving picture in commercial real estate, residential real estate firms report that there has been no improvement in the housing market since they were last contacted. Firms reported a normal seasonal increase in "traffic," or potential customers, early this spring, but this did not result in the normal seasonal increase in home purchases. Though residential construction and sales are generally slow, realtors did report that the market for homes selling below $300,000 is outperforming the market for all higher price ranges. The inventory of unsold homes is expanding, but not as quickly as it did last year. Average selling prices are basically unchanged from 2006. So far this year, the average number of days on the market has risen, but not to the highs experienced in earlier housing downturns. Realtors suggest that the correction in the housing market may result in a prolonged period of house prices rising more slowly than inflation, if at all.

Prices and Wages

Firms characterized wages as increasing at a steady pace. Employee benefits are currently exerting more pressure on costs than wages. Some businesses are providing employees with new nonwage benefits, such as gasoline cards. Some firms also noted an increase in the cost of providing employee health care.

Among their other costs, several firms reported increased prices for raw materials as a significant issue. Firms continue to report higher energy-related costs, especially the cost of electricity. Almost four in 10 manufacturing firms reported increases in the prices paid for inputs and few reported any decreases.

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Fourth District--Cleveland

Economic activity in the Fourth District grew at a modest pace during the past six weeks. In general, manufacturing output was stable to increasing, although District auto plants reported decreased production during April. Activity in commercial construction held steady with backlogs reportedly at acceptable levels. New home inventories are moving toward more normal levels, but sales remain at low levels. Further, there is a general consensus among builders we spoke with that residential construction has yet to bottom out. Most District retailers reported disappointing sales which were attributed to unseasonable weather and high gasoline prices. Loan demand at banks has been flat to slightly up with stronger demand in the commercial sector. Energy production was mixed. On balance, the demand for trucking and shipping services has softened a bit.

On net, reports point to a slight increase in employment levels across the District with little wage pressure. Staffing firms reported positive trends in job openings with an increase in the number of permanent openings; however, our contacts told us that the number of job seekers declined since mid-April and year-over-year. Hiring demand was greatest in the service industries including health care, insurance, finance, and administrative. Manufacturing openings decreased. Almost all manufacturers, commercial builders, and coal producers reported that input prices are rising especially for metals and petroleum-based products.

Manufacturing

Most District manufacturers reported production levels were stable to increasing during the past six weeks and on a year-over-year basis. Top performers were found in the aerospace, power generation, chemicals, and food processing industries. Looking forward, almost all our contacts anticipate production remaining at current levels or increasing. Auto assembly plants reported decreased production between March and April with foreign brands showing higher production cuts than their domestic counterparts. On a year-over-year basis, total auto production increased with domestic makes increasing production at a higher rate than their foreign brand competitors. Shipments by steel producers and service centers were reported as softening to up slightly and expectations for the second quarter varied widely. Stronger markets for steel include industrial equipment and machinery, commercial construction, rail cars, energy, and chemical processing.

Almost all manufacturers reported that capital expenditures were on plan since mid-April with half of the respondents saying they expect to increase spending in the next 12 months. Our contacts tell us that funding is readily available--primary sources include equity and bond issuance or internal resources. Industries planning increased capital expenditures include machinery, aerospace, food processing, structural metal products, autos, and petrochemicals. Although some of the additional capital spending is aimed at increasing production efficiencies, less than half of the manufacturers expect to see higher productivity. A majority of producers reported a rise in input prices--particularly for metals--over the past six weeks and on a year-over-year basis. In response, about half of our contacts said they increased their prices or used surcharges to pass through increased costs. Only a few of our contacts reported increasing the size of their workforce during the past six weeks including those who recalled laid-off workers. Hiring in the near future is expected to be very slow. Little wage pressure was reported.

Construction

New home sales over the past six weeks were reportedly stable--but at low levels--and down on a year-over-year basis. There is a general consensus among respondents that residential construction has yet to bottom out. Looking forward, builders aren't sure when the housing market will turn around--late 2007 may be the earliest. Although builders were in agreement that new home inventories remain high, several reported that they are moving toward more normal levels. In general, new home prices were down slightly since mid-April, although some builders have discounted as high as 10 percent. Prices of construction materials were mixed. Some contacts said prices have stabilized while others reported increases for copper and petroleum-based products such as roofing.

Most of our commercial contractors tell us that business has been stable to very good since mid-April; however, on a year-over-year basis their reports were more mixed with a third saying business is down. Segments showing strong activity include retail, public works, education, and some manufacturing. When questioned about new business inquiries, a majority of respondents said they were stable or declining. Opinions regarding backlogs varied, but overall they are at acceptable levels. Almost all contractors reported price increases for building materials--especially steel and concrete--and fuel. Profit margins were unchanged as builders were able to pass on most of the increased costs. Access to capital is readily available with banks being cited as the primary source.

Retail

In general, District retailers reported disappointing sales on a year-over-year basis. Much of the decline was attributed to unseasonable weather and high gasoline prices. Two bright spots were grocery stores and home centers. At the home centers, sales increases were attributed to seasonal items. Looking forward, retailers anticipate sales will remain flat or increase modestly--up about two percent. With the exception of some food stocks, supplier prices and other input costs have remained steady over the past six weeks, although a few contacts expressed concern over rising energy prices. New car sales have been steady since mid-April. Dealers reported that showroom traffic has picked up, although it's not at a very high level. Further, they don't expect sales trends to change very much in either direction over the next few months. SUV sales were hard to come by, especially for the larger models.

Banking

Since mid-April overall loan demand has been flat to slightly up. On the consumer side, auto and marine lending is picking up modestly while the home equity loan market has softened. The mortgage market continues to be slow with only limited expectations for a rebound in the second half of the year. Several bankers reported commercial lending to small and mid-sized businesses has increased. Almost all contacts told us that credit quality remains generally stable.

Energy

Most coal producers reported production declines since mid-April and on a year-over-year basis. All our contacts reported cutbacks in capital spending and increases in material and equipment costs, especially diesel fuel. Workforce reductions are continuing. Wages are rising at a slower rate while benefit costs are accelerating.

Reports by oil and gas producers contrasted with those of their coal counterparts. Resource development and demand were characterized as high. Production levels are flat to slightly up since mid-April and on a year-over-year basis. Capital expenditures for business expansion remain on target for the year. Funding for investment is easily available coming from internal sources and private investors. Material and equipment costs were flat to up slightly. All our contacts told us they are currently hiring and anticipate continued workforce expansion.

Transportation

On balance, demand for trucking and shipping services has softened a bit. We had a report that shipping rates for the less than truckload business softened due to a slower pace of economic activity and some overcapacity. Expectations for revenue growth during the second half of 2007 varied. Productivity in the trucking industry continues to be constrained by hours-of-service changes, congestion, and driver turnover among other factors. According to industry executives, productivity levels have fallen over the past couple years with little change expected during the next 12 months.

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Fifth District--Richmond

On balance, reports on Fifth District economic activity indicated that growth picked up a bit during late April and May. Services firms continued to be a catalyst for growth as revenues expanded briskly in recent weeks. Similarly, commercial lending activity at financial institutions remained strong since our previous report. Tourism-related business in the District also strengthened over the last six weeks--bolstered by robust Memorial Day bookings. Not all reports were upbeat, however. Softness in big-ticket categories kept retail sales weak in recent weeks, and manufacturing activity continued to contract somewhat. The reports on housing sales and prices remained generally soft though pockets of strength were noted. Reports on commercial markets, on the other hand, were mainly positive headlined by an overall increase in leasing activity. In agriculture, crop conditions were described as "fair to good" despite some concerns over moisture levels. Prices reportedly grew at a slightly faster pace in recent weeks, behind reports of particularly sharp increases in the price of materials from some District manufacturers. Wages were more varied with services firms indicating slower wage growth while retailers reported somewhat faster growth.

Retail

Retail sales remained soft in recent weeks led by weaker big-ticket sales. District automobile dealers generally said sales were sluggish, though they noted an uptick in sales of smaller, less expensive cars as gas prices continued to climb. Contacts generally reported slowing shopper traffic and several attributed decreases to higher gas prices. Some retailers also cited softness in the housing market as a factor depressing sales--a large building supply retailer, for example, noted that merchandise was moving slower in recent weeks. On the employment front, District retailers trimmed their payrolls somewhat, though average retail wages continued to increase at a moderate pace.

Services

Revenues at most services-producing firms expanded at a healthy clip during late April and May. A contact at a large North Carolina health care provider said that demand for services had remained steady since the start of 2007. Additionally, a contact at a Washington, D.C., brokerage firm indicated that revenue growth had strengthened in recent weeks. However, an executive at a North Carolina transportation services firm said demand had softened somewhat since our last report. Services firms reported that they raised their prices at a slightly faster rate from mid-April through the end of May. Despite strengthening revenues, contacts indicated that the pace of hiring and wage growth moderated during the period.

Manufacturing

District manufacturing activity continued to pull back in May. Contacts reported that the recent weakness in shipments moderated but noted somewhat larger declines in new orders and employment. By industry, demand was notably weaker at chemicals, paper, stone and clay, and textile firms. A radiator manufacturer in North Carolina told us that they had experienced a marked slowdown due to a falloff in commercial truck manufacturing. In addition, an automotive parts producer in West Virginia expressed concern regarding the future of car and truck sales. Turning to prices, contacts said that both raw material and finished good prices increased more quickly since our last report. Some manufacturers noted difficulty in passing on higher costs to their customers--a North Carolina textile producer, for example, said that recent increases in synthetic fiber prices were too large to reasonably pass on to their customers.

Finance

On balance, commercial lending activity throughout the District remained fairly strong, maintaining the pace from earlier in the spring. An exception to this picture was a Charleston, W.Va., banker's report which noted a marked decrease in demand, citing softening investment tied to lower coal and natural gas prices. District mortgage lenders reported that activity remained flat. Lenders relayed only scattered reports of rising loan delinquencies. A Charlotte, N.C., contact noted that there appeared to be no widespread impacts from the recent developments in the subprime sector.

Real Estate

Real estate agents across the District gave mixed reports on home sales activity. A Richmond, Va., Realtor reported stable home sales in recent weeks but also noted an increase in the number of contracts contingent on buyers selling their homes. Additionally, he said that clients were becoming more attuned to interest rate developments. In Northern Virginia, contacts characterized sales as "still churning away," but said inventory levels remained elevated. Reports were also generally mixed in the Carolinas. A Greenville, S.C., agent expected activity to strengthen because of a recent uptick in job growth in that area. But a Greensboro, N.C., agent told us that builders continued to offer substantial incentives to sell properties. He went on to say that he perceived a lack of confidence among buyers, due in part because of businesses leaving the area. Reports on home prices as well were with prices declining a bit in some markets while holding steady in others.

Feedback on commercial activity was somewhat brighter during recent weeks. Commercial real estate agents reported an uptick in leasing activity since our last report. Contacts noted that the increase in the demand for commercial space was concentrated in the retail and industrial segments of the market, while the demand for office space remained steady. A Washington, D.C., Realtor said that customer interest in retail space made him realize how slow activity had been earlier this year. Contacts in northern Virginia and Raleigh, N.C., reported increases in the construction of industrial space. The Raleigh agent also noted that though local industrial vacancy rates were still high, quality industrial space was generally in short supply. Reports on commercial vacancy rates and rent levels across the District indicated little change since our last report.

Tourism

Tourist activity continued to strengthen in recent weeks. Contacts at hotels along the coast told us that bookings for the Memorial Day weekend--bolstered by near-perfect weather--were notably stronger than a year ago. A contact from the Outer Banks of North Carolina said her area experienced one of the best Memorial Day weekends ever, noting that the number of vacationers had not been noticeably affected by higher gas prices. In addition, a manager at a mountain resort in Virginia said that sales of time shares were doing well and he characterized consumer spending there as robust.

Temporary Employment

Temporary employment agents across the District indicated firming demand for workers since our last report. A Raleigh, N.C., contact attributed the recent surge in activity to the continued strength of the local labor market due in part to a sizeable number of new start-ups. Similarly, a contact in Richmond, Va., reported that the strong economy in that area had boosted demand for temporary workers. In contrast, a contact from Bethesda, Md., anticipated demand for temporary workers to weaken in coming months because of a softening in local economic conditions. Overall, skilled workers remained in short supply. Contacts noted that customer service, computer and other general administrative abilities remained highly sought.

Agriculture

Warm, dry weather in late May effectively lengthened the planting season for District crops, but depleted soil moisture hindered crop development in some areas. Cantaloupe, cucumbers, snap beans, tomatoes, and watermelon plantings were generally ahead of schedule in South Carolina, as were corn, soybeans, and other vegetable crops in Maryland. In Virginia, however, an analyst expressed concern that dry field conditions were jeopardizing the development of small grain crops. Moreover, pasture conditions deteriorated somewhat in West Virginia. Nonetheless, in most parts of the District, agricultural officials characterized crop conditions as "fair to good."

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Sixth District--Atlanta

Reports from District contacts indicated, on balance, that business activity continued to expand modestly in April and May. Most retail store contacts indicated that sales were similar or up slightly from a year ago, whereas auto sales weakened. Reports from Florida's tourism sector were mixed, while other areas noted improving conditions. Builders and Realtors noted that residential home sales and construction remained at low levels, and weakness was especially evident in Florida and Georgia. The pace of commercial construction activity, on the other hand, continued to exceed year-ago levels. Manufacturing reports were varied, and the long-term outlook improved with the announcement of new plants and expansions in steel and auto-making industries. Reports on hiring remained positive on net, and several industries continued to report difficulty finding skilled labor. Contacts observed that several raw material prices had stabilized, but businesses also reported that they were facing steep increases in energy, transportation, and health-care benefits costs. Severe drought conditions adversely effected crops and livestock in Alabama, Florida and Georgia.

Consumer Spending and Tourism

Most reports from District retail merchants noted that sales levels were similar or up modestly from a year-ago in April and May. But the majority also noted that recent sales were moderately below plan, and that inventories had risen somewhat. Most retail contacts expected sales to continue to increase over the next several months. In contrast, auto industry contacts indicated that District vehicle sales had declined. Purchases of domestic brands remained sluggish, while sales of several foreign makes weakened. Lower demand for trucks and SUVs continued to be a major factor affecting sales.

Reports from the tourism and hospitality sector varied. Although first-quarter visitor numbers declined slightly in Florida compared with a year ago, numbers for the Memorial Day weekend exceeded expectations in several parts of the state. Contacts also noted that Florida's luxury hotels continued to post high occupancy rates. Industry officials indicated that, while high gasoline prices have not had a negative impact on vacationer's plans, summer travelers may be more conservative in their spending because of the higher transportation costs. New Orleans' Louis Armstrong International Airport reported year-to-date airline passenger numbers up nearly 45 percent from a year ago, but contacts there did not expect a full recovery in visitor numbers for several more years. Meanwhile, gaming revenues for April were at record levels for the Mississippi Gulf Coast.

Real Estate

Most District homebuilders and Realtors reported that new and existing home sales remained below year-ago levels. Reports suggest that home sales stabilized at low levels in parts of Florida in April and May, but declined in Georgia. Most contacts continued to report that both new and existing home inventories were up from a year ago, and that asking prices were being lowered. New home construction remained below year-ago levels across most of the region. The majority of housing contacts continue to expect home sales and construction to be weak for the next several months.

Reports from District commercial contractors indicated that the pace of non-residential development during April and May exceeded year-ago levels. However, some softening was reported by Florida contacts. The outlook among most commercial contractors remained positive.

Manufacturing and Transportation

Reports on manufacturing activity continued to vary in April and May. Slowing was reported in the chemicals, food processing, and building materials segments. Demand for housing-related products, such as framing and panels, remained weak. However, a wood pulp processor was increasing production and noted that producers were looking for continued good activity in the coming months. A contact at a Mississippi shipyard said that the company was looking to expand its workforce because of continuing strong shipbuilding activity.

The District's longer-term manufacturing outlook brightened with several new announcements. For instance, Hyundai announced a $270 million engine plant expansion in Montgomery to build four-cylinder engines for the North American car market. Honda announced a $64.5 million expansion at its Lincoln, Alabama, facility. ThyssenKrupp AG said it will build a state-of-the-art steelmaking complex near Mobile, Alabama. The $3.7 billion plant is expected to have 2,700 employees by 2010.

Transportation contacts reported sluggish freight demand in April and May. Slower activity in housing and autos were cited as factors contributing to the lower performance. Some contacts also noted slower demand from commercial construction customers in Florida.

Banking and Finance
Banking conditions in the District were generally favorable. Loan demand was stable overall, and there were reports of solid loan growth in the commercial real estate segment. Higher mortgage delinquencies were noted in some parts of the District.

Employment and Prices
Hiring remained positive on balance during April and May. However, there were reports of layoffs in the construction and real estate services sectors, especially in Florida. Homebuilders were reportedly letting go the least qualified workers that they had hired during the housing boom. However, demand remained strong for skilled construction workers such as electricians, plumbers, and heating and air conditioning technicians. Contacts in the health-care industry continued to observe shortages of healthcare professionals, and strong demand for skilled workers was noted in the defense and aerospace industries. In some areas, attracting and retaining low-skilled workers in the retail and hospitality industries was said to be difficult because of the high cost of housing.

Although several raw materials prices have stabilized, businesses reported that they were facing large increases in energy, transportation, and healthcare benefits costs. Residential and commercial builders noted lower prices for materials and construction equipment. However, a producer of electrical equipment reported increasing prices for the firm's metal and plastic inputs. Most reports on wages cited modest increases, although stronger wage gains were noted in some industries such as shipbuilding and oil rig fabrication.

Agriculture and Natural Resources
Severe drought conditions continued to negatively impact agriculture in areas of Alabama, Florida, and Georgia, while the rising cost of corn-based feed was noted by livestock producers. Contacts in the oil and gas sector continued to increase exploration and development.

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Seventh District--Chicago

Economic activity in the Seventh District continued to expand at a modest pace in April and May. Consumer spending and business outlays rose at rates similar to those reported earlier in the year. Changes in labor market conditions were mixed by industry and location. Residential construction and real estate activity declined further in most areas, while nonresidential construction expanded slightly. Conditions in manufacturing were little changed from the past reporting period. Household lending declined while business lending increased at a slower rate than in previous months. Energy costs rose significantly, but on balance other prices increased at a steady rate. Wage increases were similar to those in the previous reporting period. Corn and soybean planting recovered from early weather delays, and by the end of May crop progress was normal by seasonal standards.

Consumer Spending
Consumer spending continued to increase at a gradual rate. Retailers said that sales in April were soft due to the early Easter and bad weather but then picked up in May. Electronics were selling well, while housing-related items, such as gardening and home décor, were soft. One industry analyst noted a dichotomy between the solid results at luxury retailers and the weakness at discounters. Inventories were in line with desired levels. Vehicle dealers reported steady sales overall. Fuel efficiency remained an important concern of vehicle buyers, with consumers opting for smaller engines or economy cars. A restaurant chain reported a solid increase in sales but added that results for quick-casual were better than sit-down restaurants. Tourism was down slightly in Michigan in relation to last year, and contacts were concerned that high gas prices would lead to further declines in travel during the summer season.

Business Spending
Business spending rose again in the District. Capital spending increased at a modest rate. There was one report of a new investment project from a packaging materials manufacturer, while the majority of contacts suggested their capital outlays were continuing to rise according to previous plans. Truck freight loadings declined modestly. Changes in labor market conditions were mixed by industry and location. Toolmakers, a pharmaceutical company, and a retailer indicated they were adding workers, while a construction materials manufacturer and a homebuilder reported layoffs. A contact in Rockford, Illinois noted a decline in commercial construction jobs after two big development projects were recently completed. An analyst in Illinois revised down a forecast for job growth this year, noting some softer demand in professional and business services. Billable hours for temporary placements in low-skilled positions declined slightly, while growth in hours for professional and technical workers was steady. A staffing firm said it expected these trends to continue in the next few months, but it was getting "some signals" that its large customers were planning to add more temps later this year.

Construction and Real Estate
Residential construction declined again in most areas. Inventories of speculative new homes were being slowly worked down throughout the District, but existing homes for sale remained high. Foreclosures increased in Indiana and Michigan. Nonresidential construction expanded slightly from a year ago. A developer from Indiana said that commercial building was strong, with petrochemical, highway, and large retail at the forefront. Additionally, in some locations the medical segment was strong, however there was concern that the segment could soon become overbuilt. Industrial development was sluggish, and retail building was slowing in some areas. Pre-cast concrete components were in short supply.

Manufacturing
Conditions in manufacturing were little changed compared with the previous reporting period. A steelmaker said the market was "relatively calm" though a bit slower than in February and March. Steel inventories continued to move lower, and one contact remained confident that they would be down to desired levels by the end of the second quarter. Manufacturers of machine tools and equipment parts said they were "very, very busy" with sales growth in the mid-single digits. Demand for some agriculture machinery was also strong, particularly for products purchased by big farms. Contacts said that sales of heavy equipment were unchanged between May and April, but in general demand continued to step down from the highs of last year. New truck orders from domestic shippers remained weak, in part reflecting the increased costs of operating equipment that meets the new engine emissions requirements. However, industry analysts said that, after numerous temporary plant shutdowns in April, backlog-to-build ratios had moved from very low levels up into range that suggested heavy truck production would stabilize. An automaker thought that light vehicle inventories were "well in hand" and that vehicle production could be a positive contributor to GDP in the second half of the year. Contacts said that shipments of wallboard and cement continued to be held back by the weakness in residential construction.

Banking and Finance
Lending activity was steady from the previous reporting period. Mortgage applications for home purchases and refinancing both declined. New home equity credit issuance continued to decrease, but outstanding balances were little changed. Mortgage delinquencies edged up further during May. One contact said that banks in areas with high foreclosures were trying to work with troubled borrowers to avoid forcing them into foreclosure, and in some instances bankers were forgiving portions of the loan balances of distressed borrowers who were able to sell their home themselves. Business lending rose at a slower pace than in previous months. Standards and terms for commercial loans were little changed, and pricing remained competitive. Business loan quality was "deteriorating slightly on the edges," but one contact in Michigan said that there were "surprisingly few problems," given the weakness in the auto industry.

Prices and Costs
Outside of energy, nonwage price pressures and overall wage increases were similar to those in the previous reporting period. Almost every contact noted higher fuel costs. A retailer said that higher fuel prices had not yet affected their wholesale prices but expected they would eventually. Raw materials prices were generally steady or down: spot steel prices were flat, while scrap prices were down. Wallboard prices fell. At the consumer level, there were reports of increases in restaurant prices, while hotel room rates were stable. A few contacts noted concerns that the minimum wage increase would result in higher labor costs. A staffing firm reported that it was increasing its pay rates at a slower pace, but its billing rates rose at a steady pace.

Agriculture
After a slower-than-usual start due to cold and rain, corn and soybean planting in the District picked up during the reporting period; corn and soybean planting even surpassed typical progress in most areas by the end of May. Western Iowa experienced the worst delays as recent precipitation caused flooding, prevented fieldwork, and led to some replanting. The weather did not cause any noticeable shift from previous planting intentions regarding corn versus soybeans. Reports on crop conditions were mixed, ranging from "stunted" to "excellent." Corn and soybean prices rose from late April to the end of May, as expectations developed that a dry start to the summer might lower yields in the Corn Belt. There were indications of tight supplies of corn in areas where ethanol plants began production. Milk and hog prices moved higher, while cattle prices were lower.

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Eighth District--St. Louis

Despite mixed reports in some sectors, the economy of the Eighth District expanded modestly since our previous report. While reports from the services sector indicated continued expansion, reports from manufacturing did not present as clear a picture. Retail and auto sales increased in April and the first three weeks of May compared with a year ago. Home sales were mixed, while commercial real estate market conditions remained favorable. Overall lending activity at a sample of District banks was mostly unchanged during the first quarter of 2007.

Consumer Spending
Contacts reported that retail sales in April and the first three weeks of May were up, on average, over year-earlier levels. Half of the retailers surveyed saw increases in sales, while 42 percent saw decreases. Approximately 58 percent of the retailers noted that sales levels met their expectations, 37 percent reported that sales were below expectations, and 5 percent reported sales above expectations. Lawn and garden items and men's apparel were strong sellers, while home dï¿½cor and big ticket furniture were moving more slowly. While 63 percent of our retail contacts noted that inventories were at desired levels, 33 percent reported that inventories were too high. About two-thirds of contacts expect increased sales over 2006 levels during the summer months, 8 percent expect sales to be the same, and 25 percent expect decreased sales.

Car dealers in the District reported that, compared with last year, sales for April and the first three weeks of May were up, on average. About 46 percent of the car dealers surveyed reported increases in sales, and a similar percentage of contacts reported declines, although of a smaller magnitude. About 33 percent of the car dealers noted that used car sales had increased relative to new car sales, while 8 percent reported the opposite. Also, 38 percent reported an increase in low-end vehicle sales relative to high-end vehicle sales, while 8 percent reported the opposite. About 25 percent of contacts reported higher rejection rates of finance applications and 8 percent reported higher acceptance rates. One-third of the car dealers surveyed reported that their inventories were too low (mostly on used vehicles), while 21 percent reported that their inventories were too high (mostly on high-end and new vehicles). About two-thirds of the car dealers expect increased sales over 2006 during the summer months, 4 percent expect sales to be the same, and 29 percent expect decreased sales.

Manufacturing and Other Business Activity
Manufacturing activity has been mixed since our previous survey. While several manufacturers reported plans to open plants and expand operations in the near future, a larger number of contacts reported plans to close plants and reduce operations. Activity was mixed in the furniture, machinery, and motor vehicle parts industries, with both plant closings and openings and virtually no changes in the number of workers. Firms in the oil field machinery industry reported plans to open new facilities in the District. Contacts in the food, packaging, and chemical manufacturing industries reported plans to expand existing facilities and hire additional workers. In contrast, contacts in the electrical equipment, toy and games, and textile manufacturing industries reported plans to lay off workers and close plants.

The District's services sector continued to expand steadily in most areas. Contacts in the health services and air transportation industries reported plans to expand operations. Firms in the support services industries reported plans to hire additional workers. In contrast, a contact in the trucking industry reported a substantial decline in both inbound and outbound tonnage.

Real Estate and Construction
Home sales continued to be mixed throughout the Eighth District. Compared with the same period in 2006, April 2007 year-to-date home sales were up 4.2 percent in Louisville and 2.5 percent in Little Rock. Year-to-date home sales declined 4 percent in St. Louis and 8.8 percent in Memphis. Residential construction declined throughout most of the District. April 2007 year-to-date single-family housing permits fell in most metro areas compared with the same period in 2006. Permits declined 24 percent in Memphis, 19 percent in Little Rock, and 8 percent in St. Louis. Permits, however, were up 34 percent in Louisville.

Commercial real estate market conditions remained favorable throughout the District. The 2007 first-quarter industrial vacancy rate increased in Memphis and Little Rock over the fourth quarter of 2006, while it decreased slightly in Louisville. During the same period, the office vacancy rate was unchanged in Memphis and decreased in Louisville and Little Rock. Contacts in Louisville report that commercial and industrial construction appears brisk. Contacts in central Mississippi report that a commercial and industrial expansion project is forthcoming. Contacts in west St. Louis County report plans for a light industrial park. And contacts in west Memphis report plans for a new industrial park.

Banking and Finance
A survey of senior loan officers at a sample of District banks showed little change in overall lending activity during the first quarter of 2007. Over the period, credit standards and demand for commercial and industrial loans remained basically unchanged for both large and small firms. Credit standards for commercial real estate ranged from unchanged to somewhat tightened, while demand for these loans was basically unchanged. Meanwhile, credit standards for consumer loans remained unchanged, while demand for these loans was moderately weaker. Both credit standards and demand for prime and nontraditional mortgage loans were unchanged.

Agriculture and Natural Resources
Because of extensive frost damage in early April, many farmers throughout the District have harvested winter wheat for hay or destroyed their crop in order to plant different crops. Over half of the winter wheat in Kentucky, Missouri, and Tennessee is in poor condition, but at least three-fourths of the crop in the other District states is rated in fair or better condition. Planting of the major District crops (corn, soybeans, sorghum, cotton, and rice) is ahead of its 5-year average pace except in Missouri, where corn, soybeans, and sorghum planting is behind.

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Ninth District--Minneapolis

The Ninth District economy edged up since the last report. Growth was noted in consumer spending, tourism, commercial real estate and construction, services, manufacturing, energy and agriculture. Residential construction and real estate activity decreased, and mining was flat. Labor market conditions were mixed, and overall wage increases were moderate. Significant price increases were noted for gasoline and copper.

Consumer Spending and Tourism
Consumer spending increased modestly. A mall manager in North Dakota reported that sales were up in April and early May compared with a year ago and seemed to be above the national trend. Memorial Day weekend traffic at a Montana mall was fairly strong, according to the manager. A member of the Minneapolis Fed's Advisory Council on Small Business and Labor noted solid retail activity in northwestern Minnesota. Same-store sales at a major Minneapolis-based retailer are expected to increase by about 6 percent in May compared with a year ago. However, recent traffic at a Minneapolis area mall was down slightly from a year ago. Vehicle sales were generally slower compared with previous years, but were holding steady recently, according to a representative of an auto dealers' association in South Dakota.

Despite high gas prices, tourism businesses are optimistic for the summer season. Reservations at a lodge near Glacier National Park were going strong, according to the manager. Businesses reported stronger sales in May after a slow April in northwestern Wisconsin; inquiries for summer tourism were at solid levels, according to an official. Tourism in 2007 has been slow in the Upper Peninsula of Michigan; however, good weather led to stronger activity in May.

Services
The professional business services sector saw growth compared with last year. Preliminary results of the Minneapolis Fed's May annual survey of professional services companies showed that revenues and profits increased from a year ago and are expected to increase over the next year. In addition, respondents indicated that productivity remains strong and finding qualified workers is difficult.

Construction and Real Estate
Commercial construction grew as the primary building season moved into full swing. There are 1 million square feet of office space under construction in Minneapolis-St. Paul. However, a general contractor in Minnesota and South Dakota noted slowing growth this year. Home building remained at a low level in most parts of the District. Year-to-date home building permits were down significantly in Rochester, Minn., and Fargo, N.D. Permits in Sioux Falls, S.D., were about even with last year. In contrast, a western Montana home builder expects business to be up as much as 40 percent from a year ago.

Commercial real estate was solid. A Minneapolis-St. Paul commercial real estate firm reported strong demand for office and industrial space. A major software firm announced it would absorb an additional 60,000 square feet of office space in Fargo; a commercial developer there said the demand for industrial space is strong, while the market for retail space is soft. Respondents to the professional services survey indicated a small increase in demand for office space. However, District housing markets were mostly weak. April home sales in the Minneapolis-St. Paul area were down 10 percent from a year earlier, and sale prices were down 4 percent. In Bismarck, N.D., by contrast, the number of homes sold was about even with last year, while home values were on track to increase almost 9 percent. A survey of District rental markets showed lower vacancy rates and increased rents compared with last year.

Manufacturing
Activity in the manufacturing sector grew since the last report. A May survey of purchasing managers by Creighton University (Omaha, Neb.) indicated increased manufacturing activity in Minnesota and the Dakotas. In Minnesota, an electronics manufacturer is adding a production facility, a fiberglass product producer is expanding production and a pump maker noted increased orders. In addition, a global steel company plans to invest $1.6 billion to build an iron-to-steel mill. However, a window maker, a paper plant and a manufacturer of stone-cutting machines in Minnesota reduced production, and a lumber mill in Montana closed.

Energy and Mining
Activity in the energy sector increased since the last report, and mining was flat at high levels. Oil and gas exploration and production in the District increased from previously reported amounts. Several new wind energy projects were announced, and many are either planned or in development across the District. Mining production remained at near capacity across the District, but constraints to expansion were evident due to difficulties obtaining needed equipment, especially oversized tires for mining vehicles.

Agriculture
Solid conditions and strong prices aided the agricultural sector. Most of the District received precipitation since the last report, which aided crop conditions. Crop emergence is ahead of the five-year average for corn and soybeans. Dairy producers benefited from significantly higher milk prices. The U.S. Department of Agriculture predicted that 2007 prices would be higher than 2006 prices for corn, soybeans, wheat, cattle and hogs. Responses to the Minneapolis Fed's first-quarter (April) agricultural credit conditions survey indicated that overall agricultural income would increase during the second quarter. However, higher input costs for feed, fuel and fertilizer have agricultural producers concerned.

Employment, Wages and Prices
Labor markets were mixed. Unemployment rates in Minnesota and Wisconsin increased by 0.5 percentage points in April from a year ago. A data-storage product manufacturer recently announced plans to cut 40 research-and-development jobs in Minnesota and 390 jobs at a North Dakota plant. Also in Minnesota, a newspaper recently announced plans to cut 145 positions. Initial claims for unemployment insurance in Minnesota were up 14 percent in late April and May compared with a year ago.

In contrast, labor markets continued to tighten in the Dakotas and Montana. The unemployment rate in Montana was 2.2 percent in April, the lowest in the nation, compared with 3.3 percent a year earlier. A mine operator in Montana noted it is taking longer to fill job vacancies. A major software firm recently announced plans to expand facilities in North Dakota, which will provide space for 600 more workers. Call centers were using a variety of incentives to attract and retain employees in Sioux Falls.

Wage increases were generally moderate. According to preliminary results of the professional services survey, wages are expected to increase about 3 percent over the next 12 months. A contract agreement reached in May between registered nurses and hospitals in the Minneapolis-St. Paul area included an 11 percent raise over three years.

Significant price increases were noted for gasoline and copper. Gasoline prices at the end of May in Minnesota were 62 cents per gallon higher than a year ago. A contact noted that copper prices have increased significantly since the beginning of the year. About half of respondents to the professional services survey expect inflation to increase over the next 12 months.

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Tenth District--Kansas City

The Tenth District economy expanded at a modest pace in May. High energy prices underpinned district energy production, but limited consumer spending, especially for non-essential goods. Manufacturing production strengthened since the first quarter, though higher input costs restrained activity toward the end of the survey period. Residential real estate activity remained weak, but was partially offset by strong commercial construction activity. High crop prices and ample moisture bolstered agricultural conditions. District labor markets continued to expand at a solid pace, while wage pressures remained elevated. Price pressures intensified and contacts expected input, wholesale, and retail prices to increase further in coming months.

Consumer Spending
Consumer spending rose marginally in May after a strong showing in the last survey. Retail sales were up slightly, but below expectations as higher gas prices curtailed mall traffic. Apparel continued to sell well, while jewelry sales were weak. Store inventories were elevated and retailers anticipated slower growth in the months ahead. Auto dealers reported sales were also below expectations and lower than year-ago levels. High gas prices dampened demand for large SUVs and vans, but spurred sales of fuel efficient cars. Dealers, however, remained optimistic about future sales. Travel and tourism activity remained healthy and restaurants reported modest sales growth. Hotel occupancy rates were stable with average room rental rates up from month-ago and year-ago levels.

Manufacturing
Manufacturing activity rebounded, although high energy prices slowed activity toward the end of the survey period. Plant managers reported a rise in production, shipments, and new orders, with most industries reporting robust activity. Increased employment and an expanded work week kept order backlogs from building, despite low inventories. Capital spending plans held steady at relatively high levels. Plant managers remained optimistic about near-term output and expected exports to strengthen. However, managers were concerned that high energy prices would strain profit margins further and limit future sales.

Real Estate and Construction
The residential real estate market continued to work off inventories and commercial real estate activity strengthened further. Though still below year-ago levels, residential sales followed seasonal trends with increased sales in most District states. Low to mid-priced homes sold well, while the market for higher priced homes and condominiums remained weak. Strong housing demand was reported in cities with high concentrations of energy-related activity and in resort areas of Colorado. Median sales prices were flat or fell slightly. Stronger sales coupled with flat new home construction led to a reduction in inventory levels from the last survey. Commercial real estate activity expanded in late April and May. Commercial construction was on the upswing with the development of new office, hotel, retail and mixed-use properties across the District. Office vacancy rates continued to trend down and were expected to decline further. Absorption rates were up from the last survey and commercial rents have risen substantially over year-ago levels.

Banking
Bankers reported that both loans and deposits were unchanged since the last survey. Strong demand for commercial real estate and consumer installment loans and steady residential real estate loan demand offset easing C&I loan demand. Credit standards were mostly unchanged, although a few contacts reported tightening lending standards to reduce risk exposure in a softer local economic environment. Interest bearing deposits, such as large CDs and money market accounts, rose slightly, while non-interest bearing demand deposits declined. Lending rates held firm, but bankers reported shrinking net interest margins.

Energy
Energy activity rose in May, but remained below year-ago levels. High oil and gasoline prices fueled a modest rise in the number of active oil and gas drilling rigs in the District, especially in Oklahoma. The limited availability of skilled labor along with rising equipment and service costs continued to restrain drilling activity. However, drilling activity was expected to increase modestly given higher energy prices. Larger oil and gas royalties boosted land values in Oklahoma. Ethanol production in the District expanded further with high ethanol prices boosting ethanol profits.

Agriculture
District agricultural conditions strengthened further in May. Growing conditions improved with heavy precipitation and easing drought conditions. The winter wheat crop was in good to very good condition, though yields are expected to be hurt in parts of Kansas due to a late spring freeze. Corn planting was almost complete, despite delays in some areas due to heavy rains. Improved pasture conditions and strong seasonal meat demand heading into the grilling season underpinned profits for cattle and pork producers, despite higher feed costs. Contacts anticipated a rise in beef exports to Asian markets now that the United States is considered to have BSE (Mad Cow disease) under control. Farmland values surged with strong crop prices and rising farm incomes, especially in areas near ethanol plants.

Labor Markets and Wages
District labor markets continued to add jobs and wage pressures eased slightly in late April and May. Hiring announcements outpaced planned layoffs with most job gains projected in service industries. Demand for skilled workers remained strong, most notably for engineers. Contacts in the leisure and hospitality industry reported difficulty retaining entry level staff. Business contacts reported that labor shortages were limiting expansion plans and some companies had partnered with vocational schools to offer industry specific training programs. Wage pressures softened after intensifying in the last survey, but were expected to remain elevated compared to a year ago.

Prices
Price pressures intensified with high energy and farm commodity prices. Retail contacts reported higher selling prices in May and expected retail price pressures to build in the months ahead. Restaurants also reported raising menu prices in the face of higher food costs. Construction costs were mixed with commercial contractors paying higher prices for steel and copper, while home builders reported that lumber and wood product prices held steady. Manufacturers also reported paying higher prices for material inputs. Some manufacturers noted paying fuel surcharges, and food manufacturers paid higher prices for farm commodities. Plant managers reported higher finished goods prices and expected this upward trend to continue in the months ahead.

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Eleventh District--Dallas

The Eleventh District economy continued to expand at a moderately strong pace in April and May. There was modest improvement in the service sector. Manufacturing remains at a moderately high level. Home sales and construction continued to soften, but commercial building is robust, and leasing was more active than expected. Commercial lending continued to increase, but consumer lending still softened. Energy activity has flattened at a high level. Agricultural conditions are mostly favorable.

Many contacts have become more optimistic about the outlook for economic activity, partly because the actual effects of weakening housing markets and the pullback in subprime lending has been less than feared. Nevertheless, high freight and energy costs remain a concern for most contacts.

Prices
Energy prices have been high. West Texas Intermediate Crude oil has hovered around $65 per barrel. Brent crude prices have been nearly $7 higher. Natural gas prices are nearly $8 per million Btu. Prices continue to rise for some petrochemicals.

There is widespread concern about inflation in food prices. While higher freight and energy costs have contributed to higher prices, contacts in several industries say increased demand for ethanol has led to very high corn prices that are pushing up prices of many products, including corn starch, beef, poultry, eggs and dairy products. Several contacts said the price of milk powder--a partial substitute for milk as well as an ingredient in other products, such as bread--is at an all-time high and is expected to continue rising. Agricultural producers say the high cost of fuel and fertilizers are boosting costs.

Construction costs remain high, and contacts say building material prices are moving up again, including copper, steel, aluminum and composite aluminum substitutes. Land prices remain very high. Office rents are rising more than expected. Home prices continue to soften, however, and prices have fallen for products sold to home builders, such as lumber. Auto dealers say rising incentives and rebates have resulted in lower selling prices.

Labor Market
The labor market remains very tight for workers with specialized skills, such as CPAs, accountants, MBAs, auto mechanics, engineers and those with experience in commercial construction and the energy industry. Commercial banks report a shortage of tellers, and one contact said high school graduates no longer have sufficient math, writing and communication skills for these jobs. Wages have risen for workers in short supply--in some instances substantially.

Some firms continue to report hiring and wage pressure for unskilled workers and managers, but other firms say this market has loosened some. A few firms are laying off these types of workers to increase productivity. Most homebuilders are reducing staff because of weaker sales, and the market for subcontractors has softened.

Manufacturing
Manufacturing activity remained at a moderately high level, but reports were mixed. Some manufacturers continue to report strong demand, such as those producing transportation equipment, chemicals and items supporting the energy industry. In addition, demand for food products was up slightly. However, sales of products to homebuilders remain sluggish, and high-tech activity is mixed. Producers of corrugated boxes say demand remains solid, except for packaging for some construction-related goods. While many manufacturers reported that inventories are in line with their plans, some firms said they are intentionally increasing inventory of inputs in advance of anticipated price increases. More broadly, the decline in the value of the dollar has raised input costs for some firms but stimulated export growth for others, such as computers and petrochemicals.

There was little change in demand for construction materials, such as stone, clay and glass. The volume of new orders and sales remained flat or below last year's levels for all respondents. Orders from home builders remained soft, but demand remains solid for commercial construction and home remodeling. Inventories are higher than desired. Demand for lumber products was mixed. Some producers say demand is steady, particularly for upscale housing and commercial building, but sales to middle and low-end home builders remain sluggish. Producers of primary metals report some softening of demand in the past month, although they say activity is not as sluggish as earlier this year. Demand continues to be weak to supply residential construction, and contacts say less expensive imports are eating into market share.

High-tech activity is mixed. Several firms report continued moderate sales growth. Some contacts have seen recent improvement that has led them to be more optimistic, but others say there is still a lot of uncertainty in the industry. Excess inventory of some products, such as memory, has led to some stockpiling, but inventory is tight for other products, such as silicone and glass for flat panel computer screens. Overall, input costs are down, and selling prices are on their typical downward trend.

Gasoline demand remains healthy--with inventories 6 percent below their five year average--output is well above a year ago, and imports are strong. Chemical production is above last year's record pace. Domestic demand for petrochemicals has been modest, although there has been some recent improvement, partly to rebuild inventories. Export demand remains vigorous. Higher costs have squeezed margins some, although margins are generally healthy. Synthetic rubber is an exception, where domestic demand has been hefty and higher costs have been easily passed through to selling prices.

Services
Legal firms say overall activity was up, with strong demand for corporate transactions but weak demand for litigation and bankruptcy. Accounting firms report very strong activity. Demand for specialty services is robust, but growth in audit and consultancy services has leveled off. Temporary service firms reported a slight softening of orders to some manufacturers, but demand was hefty to supply workers to accounting and IT services.

Transportation activity has improved. Trucking business has picked up. Cargo volumes have improved at small parcel shipping firms. Container trade remains robust, with growth largely from overseas markets. Airlines report vigorous international activity. Domestic demand remains moderate. Costs continue to rise, particularly for fuel, but competition has pushed down fares.

Retail Sales
Retail sales were weaker than expected in May, but most retailers have not lowered their outlook. Recent softness was mostly attributed to high gasoline prices and unusually wet spring weather. Retailers report that repayment rates on revolving credit continue to drop, suggesting customers are under financial pressure, although they note there has not been an increase in defaults, indicating customers are dealing with those pressures. The decline in the value of the dollar has raised costs for some retailers, who report higher prices for imported products. The retail environment remains very competitive, keeping pressure on selling prices. Product prices are rising, however, and several retailers noted the importance of keeping a balance between maintaining reasonable prices and profits. Demand for autos was unchanged and roughly the same pace as a year ago. Dealers say an inventory overflow mentioned in previous reports has been reduced to manageable levels.

Construction and Real Estate
Housing markets remain soft, although contacts say demand is better than in many other areas of the country. Dallas-Fort Worth builders continued to reduce starts and expect price cuts on unsold inventory. Cancellation rates are still high in Dallas but have improved since March. Houston's housing market slowed since the last survey, despite solid job growth. San Antonio has quickly become a buyers market, with a rising supply of new home inventory and incentives "rising through the ceiling." Sales of new and existing homes continue to rise in Austin, but builders are cutting back because new home inventories are higher than desired. A recent pick up in leasing activity led respondents to be a bit more optimistic about apartment markets.

Commercial markets improved. There are signs that office leasing is picking up. Construction of office space is still strong in Dallas and picking up in Fort Worth, Houston and Austin. Warehouse leasing activity improved. Industrial investment remains steady, and selling prices are high but attractive to investors because they are much less expensive than coastal markets, according to contacts.

Financial Services
Commercial lending continues to increase and is above last year's solid gains. Credit quality is good, according to contacts, who say competitive pressures exist on pricing loans and to attract deposits. Consumer lending continues to soften, particularly for real estate and autos. Still, respondents remain optimistic, and some have improved their outlook because of reduced uncertainties regarding housing problems.

Energy
The Texas and U.S. rig counts have been flat for most of this year, albeit still at historically high levels. New rigs are entering the market, putting downward pressure on rates. Older rigs are being refurbished, repaired or stacked to await new work. The lack of growth in drilling has hurt pricing of tubulars and services, such as pressure pumping. Still, backlogs remain long, delivery can be slow and pricing is highly profitable. The high cost of engineering and construction remains a barrier to expansion in the industry, causing many projects to be delayed or cancelled.

International activity is growing; with large, long-lived projects; backed by sponsors with deep pockets; using sophisticated, high-margin services. Rigs continue to leave the Gulf of Mexico, attracted by higher rates in the strong international market.

Agriculture
Widespread rain and mild temperatures meant good progress for crops, and wheat yields are expected to be excellent. Cattle grazing conditions also improved, and livestock are in superior condition. Wet conditions temporarily halted cotton and sorghum planting and delayed the hay harvest.

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Twelfth District--San Francisco

The Twelfth District economy continued to expand at a moderate pace during the survey period of mid-April through late May. Overall price inflation was modest; growth in labor compensation generally remained moderate despite tight labor markets, although contacts noted further hefty salary increases for selected worker groups with specialized skills. Retailers in general reported moderate sales gains, while demand growth was strong for most categories of services. Manufacturers' reports were somewhat mixed but positive on balance, and agricultural producers reported solid sales. Housing market activity remained sluggish, but activity in commercial real estate markets picked up further. Banks saw further growth in loan demand with the exception of residential mortgages.

Wages and Prices
District contacts reported that overall price inflation was modest. Recent increases in the costs of energy and selected raw materials such as titanium and zinc created upward price pressures for providers of transportation services and assorted manufactured goods. By contrast, ongoing price declines for products in very competitive markets, notably apparel and electronic goods, helped to hold down overall inflationary pressures.

Growth in labor compensation was moderate overall, although it remained rapid for selected worker groups with specialized skills and in areas with very tight labor markets. More generally, tight labor markets have led employers to devote increasing effort and resources to attracting and retaining skilled workers. Contacts noted that productivity increases have helped to ease labor cost pressures in some sectors, and they expect little or no change in the rate of productivity growth this year compared with last year.

Retail Trade and Services
District retail sales continued to grow at a moderate pace on net, with most contacts indicating no change in the growth of consumer spending thus far in the second quarter relative to the first quarter. Retail sales grew at department stores and other major retail chains, and luxury items sold relatively better than lower-end items. By contrast, demand fell further for products used for home improvement. Recent increases in retail gasoline prices reportedly restrained consumer spending a bit in some areas. Automobile sales were little changed from the previous survey period. Both foreign and domestic automakers offered substantial discounts and other incentives to lure customers, and foreign models, especially fuel-efficient vehicles, continued to fare better than domestic models.

Service providers generally reported solid demand, with robust sales in the food and beverage, information technology, and health-care sectors. However, scattered reports indicated reduced demand for transportation services. Travel and tourism activity was at high levels in key District locales, but it has slowed in Hawaii after two record-breaking years, reflecting a modest decline in domestic tourism and a sharp decline in visits by Japanese tourists.

Manufacturing
Reports from District manufacturers were mixed but positive on balance during the survey period of mid-April through late May. Producers of commercial aircraft and their suppliers saw very strong demand and operated at or near full capacity to meet growing order backlogs, while orders grew modestly for products related to national defense. Apparel and food manufacturers continued to report solid sales. Makers of industrial equipment reported largely "steady" conditions, with perhaps a slight slowdown in the pace of new orders. Sales remained weak for makers of building materials, household appliances, and furniture. Semiconductor sales were up in unit terms compared with the same period last year, although price declines have held down revenue growth, and capacity utilization reportedly has dropped a few points since early 2007.

Agriculture and Resource-Related Industries
Demand for agricultural products grew at a solid pace and production conditions were stable overall. Strong demand for most specialty and commodity crops resulted in further sales growth and higher prices for these items compared with the same period last year. However, drought conditions and higher costs for feed grains have prompted cattle suppliers to accelerate the pace at which cattle are brought to market, offsetting rising demand and leading to lower cattle prices. More generally, contacts reported modest cost increases for agricultural inputs, with mixed reports regarding cost pressures associated with recent changes in energy costs.

Real Estate and Construction
Housing market activity remained sluggish, while activity in commercial real estate markets picked up further. In most areas, sales volumes for new and existing homes fell a bit further, and average time on the market rose slightly. Price appreciation slowed accordingly, with modest price declines reported during the survey period in some parts of the District. However, prices continued to rise in some states and areas where local economic conditions are strong, such as Utah, Idaho, Hawaii, and the Seattle area. On the commercial side, vacancy rates for office and industrial space fell further and rental rates continued to rise in most District cities; one exception is Las Vegas, where office vacancies rose recently due to increased supply. Construction activity for commercial and public projects expanded in some areas, partly offsetting declines in residential construction activity. Several contacts noted that the costs of construction materials continued to rise in general despite the slowdown in homebuilding.

Financial Institutions
Contacts in the banking sector reported further growth in loan demand on net. Demand for commercial and industrial lending as well as commercial real estate loans rose but was partly offset by further weakening in demand for residential mortgages in most areas. Credit quality was at favorable levels overall, but it deteriorated slightly for home mortgages in some areas. Contacts noted continued growth in venture capital funding and private equity financing.

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